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Politics this week

Nov 25th 2004
From The Economist print edition

An orange revolution?

Reuters

Ukraine was in a state of turmoil and uncertainty after the opposition leader, Victor Yushchenko, rejected the official results of a presidential election that gave victory to his pro-Russian opponent, Victor Yanukovich. Western governments backed Mr Yushchenko and America said it could not accept Mr Yanukovich's purported victory as legitimate.

See article

America's involvement in NATO's peacekeeping mission in **Bosnia** formally came to an end after nearly nine years. The European Union now takes over. A small American force will remain in the country, and its tasks will include helping to track down war-crimes suspects. Separately, the EU agreed to set up the first of a series of rapid-reaction forces, with four countries initially contributing 1,500 troops each, to be deployed anywhere in the world.

A **Russian** physicist, Valentin Danilov, was jailed for 14 years for spying for China. He insisted that the information he shared was publicly available, and that he had no links with weapons programmes.

The government of **Lithuania** said it would close one of the two reactors at its Chernobyl-style nuclear-power plant, long considered one of the most hazardous facilities in Europe. The decision would fulfil a promise to the EU, which has offered help.

Police in **Spain** arrested 90 people, including 21 minors, in a nationwide crackdown on child pornography and trafficking. The raids, which hauled in people trading images on the internet, were Spain's most ambitious effort to stop the exploitation of children for sex.

Good advice

In perhaps his last big trip to the Middle East as America's secretary of state, Colin Powell conferred with leaders of **Iraq's** neighbours in the Egyptian resort of Sharm el-Sheikh. They urged Iraq's Sunni insurgents to end their violence and let Iraqis elect a government on January 30th. At another conference, the Paris Club of 19 creditor nations agreed to write off 80% of the $42 billion that Iraq owes them.

See article

Mr Powell went on to **Israel**, where he urged the prime minister, Ariel Sharon, to help the Palestinians hold elections in the wake of Yasser Arafat's death. Mr Sharon said he would.

In Iraq, the Americans and their Iraqi allies appeared to regain control of the northern city of **Mosul**, where Sunni insurgents had risen in the past fortnight. They also began a big new offensive against rebels in disaffected Sunni towns south of Baghdad.

See article

Rwanda threatened to send its troops into Congo to smash Rwandan rebels based there, whom it said were planning to attack it. Rwanda has twice invaded Congo in pursuit of veterans of the 1994 genocide who have regrouped there.

A South African court ruled that **Sir Mark Thatcher**, the former British prime minister's son, must face questions posed by the dictatorial government of Equatorial Guinea, which suspects him of involvement in an alleged coup plot against another coup leader who now runs the place.

The British government offered to buy in advance large quantities of a promising new **malaria vaccine**, to ensure that its creator, GlaxoSmithKline, can bring it to market.

Higher intelligence

After conservative Republicans scuppered a bill that incorporated some of the September 11th commission's recommendations, George Bush said he would work with Congress to push through legislation to reform the **intelligence services**. He also ordered the CIA to increase by 50% its number of spies and personnel trained in Arabic and WMD research.

Congress passed a $388 billion multi-agency spending bill aimed at easing the budget deficit by **cutting expenditure** across a range of programmes. One casualty was funding for research into low-yield nuclear bombs, or “bunker-busters”, although this is one of Mr Bush's pet projects.

Dino Rossi, the Republican candidate for the governorship of **Washington state**, urged his Democratic rival to concede the race after a recount gave him a slender 42-vote lead. In **San Diego**, Dick Murphy claimed that he had won re-election as mayor despite protests from a bohemian local councillor that she had gathered more votes.

See article

Fighting AIDS

Health and labour ministers from **Caribbean** countries met in St Kitts to discuss how to combat AIDS. As a report from UNAIDS and the WHO confirmed this week, the region has the world's highest rate of HIV infection after sub-Saharan Africa.

See article

A suspect in last week's assassination of Danilo Anderson, a **Venezuelan** state prosecutor, died in a shoot-out with police who wanted to question him. They later said that they had found explosives and weapons in his house.

See article

Argentina announced that it would delay launching its $103 billion debt-restructuring deal after its international clearing agent, the Bank of New York, told it that the planned launch date of November 29th was not feasible.

Angry townspeople in **Mexico** lynched three plainclothes policemen, killing two of them, as TV cameras rolled. The policemen, who had been loitering near a school, were suspected of trying to abduct schoolchildren; the police said they had been working undercover on a drug investigation.

Friendly visit

Pakistan's prime minister visited Delhi, but, although the atmosphere was cordial, there was no sign of any breakthrough.

See article

Asif Zardari, the husband of **Pakistan's** former prime minister, Benazir Bhutto, was freed after eight years in prison. Miss Bhutto is now demanding the right to return to Pakistan from exile.

Three western hostages, taken a month ago, were released in **Afghanistan**.

The **Indonesian** authorities arrested four men in connection with a bomb attack on the Australian embassy in Jakarta last September.

South Korea was working hard to avoid referral to the UN Security Council after a report from the International Atomic Energy Agency detailed its cover-up of previous nuclear experiments that involved the use of uranium and plutonium.

EPA

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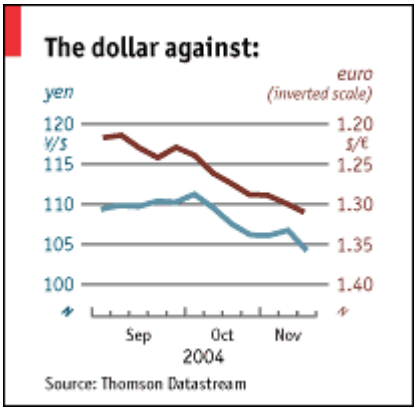
Business this week

Nov 25th 2004
From The Economist print edition

America's deficit



Alan Greenspan abandoned his characteristic style of indecipherable comment to give a blunt warning about America's current-account deficit. The Fed's chairman called it “increasingly less tenable” as foreign investors would eventually lose enthusiasm for financing the deficit. The **dollar** hit a new low against the euro and a four-and-a-half-year low against the yen shortly afterwards.

See article

Changes at the top

McDonald's lost its second chief executive in seven months. Charlie Bell, the fast-food giant's boss, stepped down to focus on his fight against cancer. His predecessor, Jim Cantalupo, had died suddenly of a heart attack. Jim Skinner, a long-serving executive, will assume the top job.

See article

Computer Associates named John Swainson, a top manager at IBM, as its new chief executive after a seven-month search for a successor to Sanjay Kumar. He resigned as boss of the embattled American software firm in the wake of an accounting scandal.

Business gamble

Trump Hotels and Casino Resorts filed for Chapter 11 bankruptcy protection after long negotiations with debtors. Donald Trump's gambling empire is languishing under debts of around $1.8 billion that have hampered the investment needed to keep up with the competition.

After a long takeover battle, **Oracle** succeeded in winning the backing of 61% of **PeopleSoft's** shareholders for its $9.2 billion takeover of the rival American software firm. But PeopleSoft's board reiterated its view that the bid was inadequate. A Delaware court said that it would consider in December the validity of PeopleSoft's “poison pill” defence against the takeover.

Wal-Mart bowed to pressure from China's government to allow trade unions in its 40 stores in the country. The world's largest retailer is notoriously chary of unions, but a workers' revolt is unlikely. China does not allow independent unions and all employees are affiliated to one run by the Communist Party.

Cingular Wireless, America's leading mobile-phone operator, said that it would cut some 7,000 jobs, some 10% of its workforce, in the wake of its recent purchase of AT&T Wireless.

Mine, all mine

Xstrata launched a hostile A$7.4 billion ($5.8 billion) bid for **WMC**, an Australian mining company. The Swiss group's bid may flush out offers from the world's other big mining firms; most are after fresh sources from which to satisfy China's ever-increasing appetite for raw materials.

Abertis, a Spanish construction and toll-road company, agreed to pay £551m ($1 billion) to acquire **TBI**, which controls eight airports including Luton, near London, and airports in Florida and Bolivia. TBI was the target of two unsuccessful bids by French and German firms in the past three years.

Byrd watching

Canada threatened the United States with **trade sanctions** in retaliation for its refusal to comply with a WTO ruling to repeal the Byrd amendment. The law allows companies that initiate anti-dumping complaints to claim any duties imposed. Tariffs would start small but could total $720m by 2007 if America begins to distribute duties levied on softwood imports.

AIG, the world's biggest insurer, said that it would pay $126m in a settlement with America's Securities and Exchange Commission and Department of Justice. The company had been accused of helping customers to manipulate their profits.

See article

ING agreed to sell **Baring Asset Management** to two American firms. Northern Trust will pay the Dutch giant some £260m ($489m) for Baring's financial-services business, while MassMutual will pay an undisclosed sum for the investment-management business.

Nice and easyJet

Despite rising fuel costs, **easyJet** reported that annual pre-tax profits had risen by 21% to £62m ($112m) after passenger numbers rose with the opening of several new routes. But the British budget airline's revenue per passenger fell as competition among low-cost carriers intensified.

Another budget airline, Italy's **Volare**, declared bankruptcy with debts of *euro*270m ($355m). Ryanair, Europe's leading low-cost carrier, quickly took advantage of this, immediately announcing an expansion into Italy.

Air France-KLM said that profits in the latest quarter were up by 41% compared with a year ago, to *euro*201m ($264m). Europe's biggest airline has cut costs and managed to boost passenger numbers. Despite rising fuel costs, the airline said that it also expected annual profits to grow.

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Private equity

Capitalism's new kings

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How private equity is changing the business world

THE rulers of the capitalist roost change remarkably often. Consider just the past two decades. In the 1980s Michael Milken and the small crowd of deal-making junk-bond financiers who followed in his wake seemed to be the kings of capitalism. In the early 1990s, the crown passed to the traders of Treasury bonds, who helped to terrify even President Bill Clinton into fiscal prudence. By the end of the decade, investment bankers appeared to occupy the throne, as they brought hot initial public offerings of shares to stockmarkets and their analysts, such as Morgan Stanley's "internet queen" Mary Meeker, touted them to eager buyers.

And today? The candidates are unusually publicity shy. Hedge funds—private pools of capital that can invest, long or short, in whatever they please—regard themselves as capitalism's top dogs, and yet they already seem past their prime. There is talk of a hedge-fund bubble, as billions of dollars pour into these funds even while their performance slumps. Besides, it is not clear that, in the scheme of things, hedge funds really matter much: they provide useful liquidity to the financial markets but, essentially, they are mere speculators who profit from correctly anticipating market movements rather than by shaping the fundamentals of the business world. That, increasingly, is the role played by a different sort of secretive pool of capital: private equity.

Transformers

Private-equity firms are those which purchase other firms or take big stakes in them (and often take public firms private by purchasing most of their publicly traded shares) in order to reshape their businesses, and then sell these holdings for a profit. Private equity comes in two main forms: venture capital, which aims to help young firms grow; and buy-out capital, which is used to improve established firms. Private-equity firms now wield much of the transformational power at the heart of the capitalist system. Although they rarely seek the limelight, the sheer clout of leading private-equity firms such as Blackstone, the Carlyle Group and Kohlberg Kravis Roberts (KKR) has attracted attention, and sometimes controversy.

Many a household name—from Burger King to Jimmy Choo shoes—is owned by a private-equity firm. Many big mergers or takeovers now involve private-equity firms. Even if they are not acting as buyer or seller, their potential interest is, at a minimum, putting a floor under the deal price. Five firms are jointly planning the biggest private-equity deal yet in Europe: a $14 billion purchase of Auna, a Spanish telecoms group. Last week's merger of Sears and Kmart, two big American retailers, was led by Kmart's private-equity owner, Edward Lampert's ESL Investments (one of a growing band of hedge funds that are also doing private-equity deals). Here is one crude measure of the rise of the industry: in the *Wall Street Journal*, *New York Times* and *Financial Times*, the use of the term "private equity" this year is up by around 60% compared with just two years ago, and by over 3,000% in the past ten years.

Yet if private equity is now king, is that something to celebrate? Are private-equity firms using their power wisely? Do they really create economic value for anyone but the people who run them? And is it really desirable, in this age of transparency, for such secretive firms to have so much power?

As is explained in our survey of private equity published in this issue, it is frequently a force for good—in

many ways a superior model of capitalism to that based on firms traded in public stockmarkets (though neither model can thrive without the other). In private equity's infancy in the 1980s, firms such as KKR and Forstmann Little, though derided as “corporate raiders”, pioneered efficiency-enhancing innovations that are now standard business practice: a focus on cash flow; the better use of debt; and equity-based pay as a way of offering incentives to managers to act more in the interests of shareholders. Today, private-equity firms often seem to provide better corporate governance than is generally found at many public firms, whose shareholders usually own too small a stake to keep management in line. (Ironically, the recent wave of new corporate-governance regulations has made more people in public companies yearn to go private.) Despite their early reputation as asset-strippers, private-equity firms increasingly help companies to maximise their long-term value by protecting them from stockmarket pressure.

In the 1980s and 1990s, private-equity firms helped to break up America's many badly run conglomerates, taking neglected non-core businesses off their hands, polishing them and finding more suitable owners. They hope to repeat this trick in other places where inefficient conglomerates are rife, starting with continental Europe—especially Germany. The efficiency gains for Europe's economies could be huge. Private-equity firms are also pioneering restructuring in Japan, starting with its wretched banking system. Private-equity firms have high hopes of spreading cutting-edge business practice to nascent economic superpowers such as China and India as well—though it remains to be seen if they can pull this off.

Private doubts

Yet not everything about private equity is wonderful. Greater transparency is needed. This is not because many of these firms are part of a scary political/military/industrial complex, as some critics (along with the re-makers of “The Manchurian Candidate”) fear, but simply because growing amounts of pension-fund money are being invested in them, and the beneficiaries of these funds have a right to know how their savings are being used. The challenge for private-equity firms is to meet this legitimate demand without giving away commercially useful information, or succumbing to the short-term financial pressures they have sought to escape.

Another risk is that too much money will flow into private equity, creating a bubble—just as may now be happening in hedge funds. As private equity grows, and its leading firms become even bigger, there is also a danger (perhaps it is already becoming a reality) that they will lose their edge. If that happens, it will be time for capitalism to crown a new king.

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Ukraine

Ukraine on the brink

Nov 25th 2004
From The Economist print edition

To the wrong Victor the spoils?

Get article background

EPA

"YU-SHCHEN-KO". Such rhythmic chanting by the demonstrators in Kiev's Independence Square and in front of the Rada, Ukraine's parliament, this week has been both depressing and uplifting. Depressing, because the Ukrainian people were protesting against a naked attempt by supporters of Victor Yanukovich, the current prime minister and choice of the outgoing president, Leonid Kuchma, to steal their presidential election on November 21st. Yet also uplifting, because hundreds of thousands of ordinary Ukrainians, many of them young, wearing orange ribbons and scarves, were prepared to brave freezing temperatures and snow to demand peacefully that the rigged result be reversed in favour of their candidate, Victor Yushchenko. At stake is not just a disputed election result. Ukraine's future is in the balance.

That the election was fraudulently conducted is not in doubt. International observers from the Organisation for Security and Co-operation in Europe, from America and from the European Union all reported widespread violations on a scale greater even than in the first-round vote three weeks ago, although the media coverage was less overtly biased this time. There was fraudulent use of absentee ballots, election monitors were ejected and turnout figures as high as 98% were recorded in parts of Donetsk, Mr Yanukovich's home region. The election count gave Mr Yanukovich victory by almost three percentage points. But a fair vote could well have gone Mr Yushchenko's way.

Civil disobedience, or civil war

The most immediate question is, what should Mr Yushchenko do now? So far, he has held firmly to the moral high ground, insisting that all protests remain calm and peaceful, and avoiding any provocation of the police. Yet in the days ahead he will need to tread a fine line between protest and civil disobedience, and an anarchy that could lead to fighting and bloodshed. Tensions between the western part of Ukraine (overwhelmingly pro-Yushchenko) and its eastern regions (overwhelmingly pro-Yanukovich) were already high: civil war is imaginable. At mid-week, Mr Yushchenko's side seemed prepared to negotiate with Mr Kuchma and Mr Yanukovich, in an attempt to work out some sort of peaceful resolution. Following the lead of Colin Powell, America's secretary of state, Western governments are refusing to recognise Mr Yanukovich's victory and are calling for a peaceful compromise. If they keep up the pressure, a way might be found: a complete recount, a setting-aside of the most blatantly fraudulent votes, even a re-run of the election.

And if the search for compromise proves elusive? The Yushchenko camp is loth to settle for anything less than victory. The government might resort to force to disperse the protesters, after a decent interval has taken them off the front pages—and then install Mr Yanukovich. This would raise a second big question: how should the West respond?

The crisis over these elections is primarily for Ukrainians to resolve, but outsiders have a strong interest. The Russian president, Vladimir Putin, was swift to congratulate Mr Yanukovich, for whom he had openly campaigned. Russia is determined that Ukraine should not follow the example of Georgia, whose "rose revolution" of a year ago brought to power a pro-western president, Mikhail Saakashvili (who is, as it

happens, a good friend of Mr Yushchenko's). Mr Yanukovich might well not be a Russian puppet, any more than is Belarus's authoritarian president, Alexander Lukashenka—but he would certainly tilt the country away from the West and towards Moscow.

Avoiding another Belarus

Ukraine matters even more than Belarus or Georgia, in terms of size (almost 50m people), in economic significance (crucial oil-and-gas pipelines cross its territory) and in strategic importance. In the end, western governments will have to engage with whichever leader emerges. Yet fears that the country might be driven further down the same authoritarian path as Belarus should not deter them from forcefully protesting if Mr Yanukovich assumes the presidency come what may. Nor should America be swayed by the presence of Ukrainian troops in Iraq (the country has one of the bigger contingents). And nobody should be put off by fears of offending Mr Putin, whose interference in Ukraine, as in other parts of the former Soviet Union, has already gone far beyond the legitimate.

To acquiesce in an overt undermining of Ukraine's nascent democracy in the interests of realpolitik would not only be a miscalculation, as well as a bad example to set for other more-or-less authoritarian countries from the former Soviet Union. It would also betray the thousands of Ukrainians who are out in the streets of Kiev and other cities, who look to the West as their inspiration. Moreover, it would do little to coax a Yanukovich-led country away from the unhealthier aspects of Russia's influence. Should the worst happen in Ukraine, then, Americans and Europeans should not hesitate to punish those responsible, for instance by imposing visa bans, or freezing their assets abroad—the sorts of measures that have already been imposed on Belarus for its rigged elections.

If sticks need to be wielded, though, there should also be carrots. America and Europe have been actively encouraging Mr Yushchenko, and assisting civil-society groups in Ukraine. They should continue to do both. But they should also consider offering more concrete inducements to Ukraine in return for steps back towards the proper democratic track: cuts in Europe's high tariffs on steel and farm goods, for example, or progress with Ukraine's bid for membership of the World Trade Organisation and a readiness to classify it as a “functioning market economy” (a status already conceded to Russia, whose economy looks less worthy of the title). Above all, the European Union should look for ways to repeat the trick it has managed so successfully with central Europe and, more recently, with Turkey: to dangle the prospect of membership, however distant, as a lure that pulls Ukraine, whoever turns out really to have won this time, more firmly towards liberal democracy. The brave people in Ukraine's streets are ready: is Europe?

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Trade relations

Talking turkey

Nov 25th 2004
From The Economist print edition

Peter Mandelson is Europe's new trade tsar. Relations with America will determine his success

AP

EXIT a technocrat and marathon-runner; enter a political operator. On November 22nd, Peter Mandelson, a long-time consigliere to Tony Blair, Britain's prime minister, began work as the European Union's trade commissioner, succeeding Pascal Lamy, who has steered the EU's trade policy since 1999. Mr Mandelson's success will be decided by how well, or how badly, he deals with America.

Not only is America the EU's biggest, and often most fractious, trading partner, but any progress towards freer global trade depends crucially on leadership from both America and the EU, the two biggest participants in international trade. For the moment, Mr Mandelson's American counterpart will be Bob Zoellick, the Bush administration's trade representative since 2001. Although America's trade chiefs rarely last more than one presidential term, Mr Zoellick shows no sign of departing immediately.

A fellow long-distance runner, Mr Zoellick got on famously well with Mr Lamy. Despite the crass protectionism of Mr Bush's early years, when he increased both steel tariffs and farm subsidies, trade policy has been a notable exception to the broader political tension between the Bush administration and “Old Europe”. Messrs Zoellick and Lamy worked hard to launch the Doha round of global trade talks in 2001, and subsequently to keep them alive. Though there were bilateral disputes, on issues such as tax subsidies and steel, the mood was one of workmanlike co-operation.

Messrs Mandelson and Zoellick must now maintain that co-operation. It will not be easy. With the dollar at new lows against the euro, and likely to slide further, the economic environment will be volatile. And the trade challenges will be tougher. The heavy lifting of the Doha trade negotiations is still to come. Poorer countries must cut their industrial tariffs and open their service sectors. Rich countries, especially the EU and America, need to be serious about freeing farm trade. Though the EU has shown some courage on farming, both sides still have a long way to go. Their trade negotiators must now push the Doha round forward, and avoid using each other as an excuse for inaction.

In his first days in the job, Mr Mandelson has shown no shortage of ambition. He has declared Doha his top priority. He also wants to push “closer regulatory convergence and mutual recognition of standards” between America and Europe. That is a good idea. In far too many areas, from drug testing to food safety, bureaucratic turf battles mean that the two trade behemoths have costly regulatory duplication.

But the real test will remain how trade disputes are managed. Mr Mandelson says he prefers negotiation to litigation and favours “early-warning systems” to stop spats getting out of control. That, too, sounds good. Whether it means anything is less obvious, and will soon be tested in a dispute over subsidies to Airbus and Boeing. After America abruptly cancelled a long-standing agreement on civil aircraft, both sides have moved towards challenging the other's subsidies at the World Trade Organisation. Airbus/Boeing will dominate the agenda, but there are also other sores: from America's failure to repeal the Byrd law, an anti-dumping provision ruled illegal by the WTO, to its frustration with the EU's attitude to hormones in beef and genetically modified food. Mr Mandelson's political talents are famous in Britain. He now needs to demonstrate the same skill on the global stage.

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Britain's economy

Why worry?

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From The Economist print edition

Economic success has made Britons smug. That's dangerous

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IT TOOK about 20 years to repair the damage done to the British economy in the 1960s and 1970s. First came Margaret Thatcher's microeconomic reforms in the 1980s—privatisation, deregulation and laws to restrict the trade unions. Then came Labour's blow for macroeconomic stability—handing over monetary policy to the Bank of England in 1997. Together, these moves transformed the British economy from one of the worst in the rich world to one of the best. Which is why, when Gordon Brown, the chancellor of the exchequer, gives his pre-budget report on December 2nd, explaining the position of the public finances, he will do a certain amount of trumpeting about the government's economic success.

Britons have come to expect that sort of thing. It took a long time for them to shed their sense of post-imperial decline; but, after years of impressive economic figures, they have grown comfortable with their success. Too comfortable, perhaps: grateful, and understandably so, for this government's contribution to their current sense of economic well-being, Britons are not paying enough attention to the ways in which Labour is undermining the success that it helped nurture.

Those poor, sad French and Germans

By the standards of most rich-world countries, Britain's economy, which should grow by 3.2% this year, looks pretty good, but the comparison with Europe shows it in a particularly favourable light. France will grow by around 2.4% this year, Germany by 1.5%, Italy by 1.1% and the euro area as a whole by 1.8%. Unemployment is running at 4.6% in Britain and 8.9% in the euro area. The contrast is particularly satisfying to Mr Brown—not just because everybody likes to do better than the neighbours, but also because he takes the credit for preventing Tony Blair from taking Britain into the euro.

There are, of course, a few obvious worries. The high price of oil will shave growth—though probably by less than elsewhere, partly because Britain remains a significant oil producer, and partly because manufacturing makes up a relatively small share of its economy. More troubling is Britain's turbulent and overpriced housing market, which 15 years ago pitched the economy into recession. Now that house prices seem to be falling once more, there are fears that the same might happen again.

That is unlikely. The economy is more resilient than it was in the late 1980s and early 1990s, largely because it is better managed. Inflation, interest rates and unemployment are low, so the chances of people running into serious difficulty with their mortgages are also lower than they were then.

If these two much-talked-of threats are not as serious as is generally supposed, where's the problem? Not so much in the vagaries of the world economy or the housing cycle as in the more controllable area of government policy—specifically, public spending and regulation.

At 42.6%, the state's share of GDP in Britain still contrasts favourably with the euro area's 48.4%. But euro-area governments understand that their high spending and consequent high taxes have undermined competitiveness, and are therefore cutting the state's share of GDP. Britain's politicians, meanwhile, are

raising taxes and spending in order to move towards the social-democratic ideal with which other Europeans have become disillusioned. When Labour came to power, in 1997, the gap in public spending's share of GDP between Britain and the euro area was 9.2 percentage points. Now it is 5.8 percentage points, and still falling.

Businessmen used to dealing with regulations in the rest of Europe often speak enthusiastically about the contrast between Britain and the mainland. That may not last. British business is being buried by a pile of new regulations. Some—such as the working-time directive—come from Brussels. Some don't. This supposedly business-friendly government increasingly uses companies as unpaid state employees. Through their payrolls, they now have to do 23 jobs for the government, from doling out maternity pay and tax credits to collecting fines and student loan repayments. When Labour came to power, the number was 15.

British people are not, according to polling figures, worried about the economy. It has slipped way down their list of priorities: according to YouGov, a pollster, the economy is currently 13th on the list of voters' top concerns. Given how comfortable things are, that's not surprising, but it is troubling. Voters ought to be worried: it takes longer to repair an economy than it does to ruin one.

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Regulating drugs

First do no harm

Nov 25th 2004
From The Economist print edition

Americans do not need a new drug regulator. But they can make their existing one work better

MEDICINES save lives. But they also claim them: even the humble aspirin can kill. For this reason, governments take it upon themselves to approve the use of new drugs and oversee the safety of existing ones. In America, this burden falls on the shoulders of the Food and Drug Administration (FDA), an underfunded and unloved bit of the federal bureaucracy. Recently, Americans have been scandalised by allegations that the FDA has been putting the commercial interests of the drug firms it regulates before the safety of patients. Calls for sweeping changes to the system have followed. Yet before these changes get rushed through, it would be wise at least to reflect on an ancient principle which has served medicine well for centuries: first, do no harm.

The FDA has not had an easy year. Stung by accusations that it ignored evidence that antidepressants boost suicidal tendencies among teenagers, the agency has also been blamed for not spotting problems with flu-vaccine manufacturing. Most explosively, an investigation by Congress into the withdrawal in September of Vioxx, a pain-reliever, last week seemed to uncover proof that the FDA sat on evidence that the drug was unsafe, and that it had bent itself to the will of Vioxx's manufacturer, Merck. Testifying before the Senate's finance committee, David Graham, one of the agency's own staffers, accused his employer of betraying the public trust and creating a “terrible tragedy and a profound regulatory failure” (see article). Dr Graham testified that up to 139,000 Americans may have suffered heart damage as a result of taking Vioxx. Of these, said Dr Graham, 30-40% have died.

A delicate balance

Drug regulators aim to balance the potential benefits of a new, or existing, medicine against the risks of taking it. As in other countries, America splits this task into two halves. One bit of the FDA devotes itself to approving applications for new drugs, another to monitoring the safety of medicines it has already approved. Wisely, the system recognises that delays in approving new drugs also cost money and lives: new-drug trials are not designed so comprehensively as to capture all adverse reactions, which may take years to appear. The task of monitoring drugs after they come to market is left to the bit of the FDA that oversees already-approved medicines. Dr Graham's main allegation is that the FDA fails to police approved drugs adequately because it is reluctant to admit there are safety problems with a drug it has already accepted. Papers published this week on the website of the *Journal of the American Medical Association* (JAMA) suggest that the system also suffers because it relies too heavily on the willingness of drug companies to report the potentially harmful effects of their own products. This asks them to put their profits at risk.

Both Dr Graham and JAMA have a ready answer to these supposed problems: take the task of post-approval drug monitoring away from the FDA and give it to an independent federal agency. This would certainly take care of any suspicions that the FDA shields the drugs it approves from subsequent relabelling or withdrawal. But it might also make it harder to strike a rational balance between the benefits and risks of new drugs. A separate regulator dedicated solely to the purpose of ridding America of harmful drugs is much more likely to err on the side of caution than one which is asked to strike that balance, as the FDA is now. It was not long ago that America was up in arms about the ever-lengthening

time it took the FDA to approve new drugs. At some stage, the pendulum is likely to swing back that way.

Clearly, the FDA is not working as it should. Morale is low and staff turnover is high. The office responsible for overseeing the safety of approved drugs gets by on miserably thin funding and uncertain support from the rest of the agency. But before America creates a new regulator with new problems, it should at least try to make the existing system work better.

One positive step would be to give the agency more power to enforce proper post-approval testing by firms of all drugs, and not just those which fall into certain categories. Drug regulators in Japan and Europe already have this power. The FDA also needs a big enough budget to do some of this work itself. And most urgent of all, it needs to be given firm, stable leadership. For much of the past four years, the FDA has had to make do without a boss. That is shockingly negligent management of an organisation upon which so many Americans (not to mention foreigners) depend for their health. President George Bush should correct it at once.

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France

Sarkozy versus Chirac

Nov 25th 2004
From The Economist print edition

Can a new France emerge from the old?

AFP

Get article background

WHEN Jacques Chirac was first elected to parliament, Lyndon Johnson was in the White House, George Bush was at Yale, and Tony Blair was 13 years old. After 37 years in politics, nearly ten as president, Mr Chirac has come to personify France. Abroad, his anti-war stance over Iraq typified an independent foreign policy, inspired by Gaullism and spiced with a dash of anti-Americanism. At home, his record after nearly a decade in office hardly bears the mark of reformist resolve. If there is a French exception, Mr Chirac is its embodiment.

Yet, despite the long shadow that the septuagenarian casts over his country's politics, Mr Chirac's is not the only France. A younger generation is challenging his old France. On November 28th, one representative—Nicolas Sarkozy—takes over Mr Chirac's ruling party, the Union for a Popular Movement (see article). Mr Sarkozy's political mission is to refresh the party for the 2007 presidential election. But his personal mission is to prepare himself as a candidate. Since Mr Chirac might also stand again, undeclared warfare is promised. At stake is a choice between the old France and the new.

The creed of French exceptionalism asserts that there is a way of running affairs—a heavy state, high taxes, trammelled markets, an independent foreign policy—which differs distinctly from the liberal, market-driven Anglo-American model. In the past, France's *dirigisme* has served it well. High-speed trains, nuclear energy, the aerospace industry, good state schools: all testify to this. The French economy, with many first-rate global companies, is the world's fifth-biggest.

Yet the model is showing its limits. Even during buoyant economic growth, unemployment remains high (8-10%). A shortened working week has freed up leisure time, but frozen earnings and stifled job creation. France has trouble accommodating its young Muslim population. Demographic pressures threaten to burden the next generation with heavy costs. Worse, the model now brakes—not boosts—economic growth.

Mr Chirac has shown no inclination to give the underlying model a rethink. He has not cut taxes much, nor streamlined the bureaucracy, nor shaken up the labour market. Indeed, his prime minister, Jean-Pierre Raffarin, says that, after implementing (modest) reforms of state pensions and health-insurance, the hard part is now over. Abroad, Mr Chirac continues to tout his vision of a multi-polar world, in which European power balances America's, in ways that seem confrontational, rather than constructive. This may shore up his credibility with the electorate. But it also disguises a more general dissatisfaction, both with his government and him.

New face, new ideas, old problems

Would the man who yearns to inherit the Chirac crown prove any better? While he presents himself as a moderniser, Mr Sarkozy is not without flaws, not least of them his relentless self-promotion. He supports an overly strong industrial policy. As finance minister, he failed to make deep cuts in spending. Could he face down the unions? Could he resist the political clientelism that has characterised Mr Chirac's reign?

Yet Mr Sarkozy brings fresh ideas. He is as close to a liberal as is possible in a country where Communists are considered part of the centre-left mainstream. He does not shy from subjects avoided in polite (secular) society: the place of religion, the compatibility of Islam with western democracy, the erosion of the work culture, the perils of the wealth tax. He has an uncomplicated approach to America, in favour of restoring warmer relations and ending unnecessary hostility.

Mr Sarkozy's ascent comes at a fluid time in French politics. A split is opening up on the left as well as the right. On December 1st, the Socialist Party votes on whether to back Laurent Fabius, its number two, in rejecting the European Constitution in next year's referendum. If it does, this could tear the left in two—and even lead to France voting no to the constitution. Mr Fabius has tapped into an uncomfortable popular sentiment that an enlarged Europe is drifting out of France's grasp.

In short, this is a time of introspection, about France, and its influence in the world. Mr Sarkozy does not have all the answers, and some of his answers are wrong. But he is stirring a welcome debate about how a New France might look.

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Letters

Nov 25th 2004
From The Economist print edition

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Patently absurd

SIR – Patents stifle competition by granting monopolies, so why not abolish the system ("Monopolies of the mind", November 13th)? No evidence suggests that the Wright brothers would not have invented the plane in 1903 unless they got a patent on it. Yet the brothers launched patent litigation against Glenn Curtiss and other domestic competitors that kept the United States far behind France, Britain and Germany. By 1917, the government forced the big aviation pioneers to create a "patent pool" available for licence by all.

Other examples of pernicious patents abound. The Seldon patent, taken out at the birth of petrol and electric cars, stifled development of that new technology. Earlier, James Watt's shameless exploitation of his steam-engine patent enriched him while slowing progress as a whole. Many other examples show that patent systems do more harm than good. Unless patents promote innovation and economic growth why bother with them?

Edward Durney
Millbrae, California

SIR – You say that "once awarded, a patent is hard to revoke" ("The cost of ideas", November 13th). This is true only for the little guys without sufficient resources. There are so many ways to avoid infringement, such as by invalidating the patent, that those with deep pockets have few problems circumventing the system. Many of your suggested reforms will, if adopted, only exacerbate the problems for independent inventors and small companies.

Sheridan Neimark
Washington, DC

SIR – You do a disservice to your readers by failing to recognise that the vast majority of patent applications are competently examined and properly issued by trained, skilled and thoughtful patent examiners. The patent system, despite a few faults, continues to make a substantial contribution to the economic well-being of society.

Eric Stasik
Stockholm, Sweden

Neo-Roman empire

SIR – It is increasingly evident that America is becoming like a new Roman empire (Charlemagne, November 13th). At the same time, Europe is becoming like the city-states of ancient Greece—self-governing but dominated by a forceful imperialistic neighbour. Perhaps the war in Iraq and fall of Baghdad last year will turn out to be as important a milestone in history as the eradication of Carthage during the third Punic war, which marked the rise of the Roman empire. Will America become an autocratic tyranny like its predecessor, waging pre-emptive wars across the globe in pursuit of an ever-lasting *Pax Americana* and prosecute any one who does not share their belief in the right set of gods? Europeans must get their act together and challenge the might of America in all sectors of society before it is too late.

Erik Kärnekull
Kalmar, Sweden

A question of religion

SIR – You call the killing of Theo van Gogh a “political murder” (“Another political murder”, November 6th). Mr Van Gogh was a film director and not a politician (like Pim Fortuyn), neither did he have political ambitions. He didn't even vote, refusing to partake in what he called a “charade”. His murder was motivated by religion and was an attack on free speech. He was killed for his views on Islam.

Roel van der Kamp
Groningen, The Netherlands

Popular lawmaking

SIR – You describe an authoritarian Hugo Chávez as passing a set of repressive laws and harassing measures against dissidents (“Red tide rising”, November 6th). These past few years an opposition with little democratic vocation has carried on with a coup d'etat and a devastating oil strike that cost the country over $10 billion, and has continuously promoted civil disobedience, incited violence and systematically harassed public officials. Based on its power over the media and economy, it has continuously denied legitimacy to the government, notwithstanding the fact that Mr Chávez, his policies and supporters have won nine successive elections in the past six years. Mr Chávez's proposed set of laws aims at re-establishing the principle of authority, the rule of law and the citizen's right to television that does not incite violence.

Alfredo Toro Hardy
Venezuelan ambassador
London

SIR – You paint a picture of Venezuela that is eerily similar to that of America. George Bush, like Mr Chávez, has narrowly won a referendum on his presidency. Mr Bush's party controls Congress, the military and, through his appointments, the judiciary. The opposition party is struggling for identity and is thoroughly disorganised. Mr Bush's moral agenda and anti-terrorist legislation, while seemingly sensible responses to current trends, may easily be misused to undermine the ability of the opposition to voice an opinion effectively. For the past century, America has led the world as an ideal in democracy. Unless we start learning from goings on outside our own borders we stand to follow Venezuela down the slippery slope towards a one-party system.

Aamer Jamali
Los Angeles

Moral authority

SIR – Why did I vote for George Bush (“The triumph of the religious right”, November 13th)? After all, I am a proud independent who supports the candidate that comes closest to my views. Mr Bush did not deserve my vote because of his policies on the environment, economy or Iraq. It came down to the question of morality and specifically abortion and gay rights. The Democrats did not set limits. Their position was open-ended and I could not see where it would stop. Society must take a stand on what is right and wrong.

Jim Kreisel
Winona, Minnesota

SIR – You fail to mention the effect on his re-election of Mr Bush's unprecedented payments through federal faith-based initiatives to religious organisations (and the promise of more to come). As George Bernard Shaw said: “A government that robs Peter to pay Paul can always depend upon the support of Paul.”

Scott Morris
Urbana, Illinois

SIR – The ideological split in America is not between left and right or moral and amoral. Instead, it

reflects the world view of voters. Those with a natural perspective, such as farmers, ranchers or even child rearers understand the progression of planting seeds, nurturing growth and patience for the harvest. These people tended to vote for Mr Bush. Those who wish the world to resemble a 30-minute sitcom with a laugh track tended to vote for John Kerry. This difference is reflected in the distinct geographical distribution of the election results as well as Europe's seeming disdain for Mr Bush.

Al Mudrow
Orem, Utah

SIR – Q: What is the difference between 16th-century England and America today?

A: In 16th-century England, the head of state chose the religion; in modern-day America it is the other way round.

Dan Haggarty
Toronto

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Old France, new France

The changing of the guard

Nov 25th 2004 | PARIS
From The Economist print edition

AFP

As Nicolas Sarkozy takes over Jacques Chirac's party, it signals the beginning of a battle of ideas over the future of France

Get article background

IN THE summer of 1975, at a party congress in Nice, an energetic and ambitious young French centre-right prime minister introduced to the packed auditorium an equally energetic and ambitious centre-right party youth member. The 20-year-old student had travelled on the overnight train, and had written his first political speech on a single sheet of paper. The prime minister warned him to speak for no more than five minutes. Defiant, intoxicated by the applause, he went on for 20. The prime minister was Jacques Chirac. The young hack was Nicolas Sarkozy.

As with fine wine, France likes its politicians to mature over time. The rivalry between this pair is of unusual vintage. It was at that Nice congress that Mr Chirac first spotted Mr Sarkozy: he summoned him to the prime minister's office the next week. The young man became his protégé, but fell from grace when he backed a rival presidential candidate against Mr Chirac in 1995. Since then, the *fils rebelle* has been a thorn in President Chirac's flesh.

Now the story takes a new turn. On November 28th, at a stage show outside Paris, Mr Sarkozy will be declared the overwhelming winner of an election to head the Union for a Popular Movement (UMP), the ruling party and the descendant of the one Mr Chirac launched a year after the Nice congress. Mr Sarkozy succeeds Alain Juppé, Mr Chirac's preferred heir, who in January was found guilty—pending appeal—of political corruption. The man Mr Chirac most distrusts is about to get his hands on the party the president created.

Running the party might appear a marginal job in a system that invests so much power in the president and so little in parliament. It is surely a lesser job, too, than finance minister, which Mr Chirac is insisting Mr Sarkozy relinquish. In reality, the post gives France's most popular centre-right politician an electoral machine and a platform from which to develop an alternative vision for France, and to position himself as the natural candidate for the 2007 presidential election.

Although they spring from the same political family, Mr Chirac and Mr Sarkozy embody two quite different and competing ideas about the future of France. Mr Chirac is a neo-Gaullist conservative who

believes that French power should be projected through a strong Europe, built on the Franco-German axis and forming a counterbalance to the United States. At home, he defends the costly but comfortable French social model. And he believes that France's Muslim population—Europe's biggest, at around 5m strong—is best served by traditional means of integration: strict separation of religion and state, and equal treatment of individuals before the law. “There is no crisis,” says one of his advisers. “Therefore, there is no need for fundamental reform.”

Mr Sarkozy, by contrast, has no time for tradition for tradition's sake. In an enlarged Europe, he argues that France can no longer rely on the Franco-German motor and needs to cultivate a group of six that also includes Britain, Spain, Italy and Poland. Atlantic-minded, he urges a milder approach to America. He advocates an overhaul of the French social model, pushing for less state regulation and a more flexible labour market; his inspirations are Britain and Spain, not moribund Germany. He considers that the French model of integration has failed French Muslims, and argues for American-style social engineering to help minorities advance. In short, where Mr Chirac urges caution and conservatism, Mr Sarkozy presses for modernisation and change. “France is not eternal,” says one of his aides. “If it does not reform, it will disappear.”

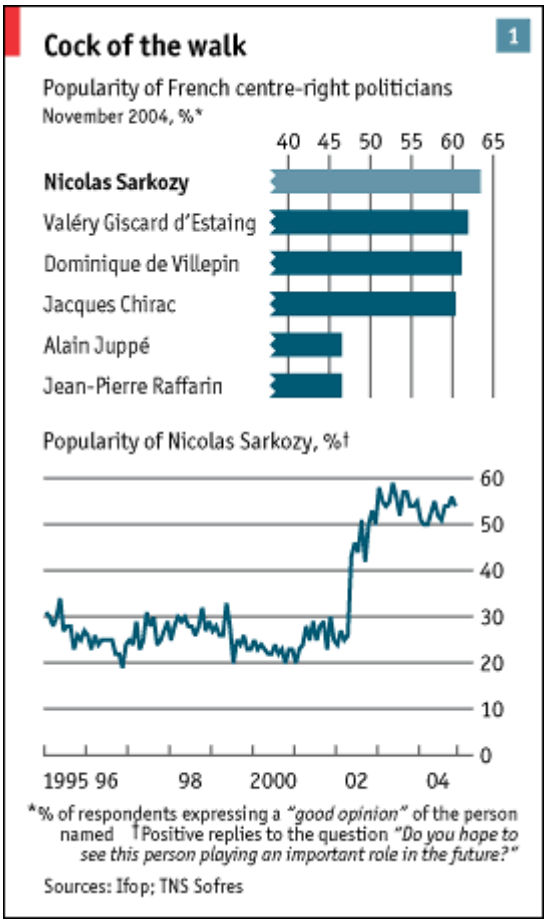
These two contrasting appraisals reflect two quite different political personalities. Mr Chirac was first elected in deeply rural Corrèze. Farming was his first ministerial portfolio, and he is seldom more at ease than when caressing a Charolais bull at an agricultural fair. He may be married to an aristocrat, Bernadette Chodron de Courcel, but he embodies less an upper class than an upper caste in the republican tradition: as an *énarque* (a graduate of the Ecole Nationale d'Administration, France's post-graduate civil-service college), he glided effortlessly into the high offices of state.

The French may know that Mr Chirac is an old-style rogue—despite many questions concerning his time as mayor of Paris, he remains protected from prosecution while in office—but they seem to find him a reassuring one. Fully 76% of the French like the way he represents France abroad. With this veteran political survivor and defender of French *grandeur*, they know what they are getting.

Mr Sarkozy, however, is unlike other politicians. His father was a Hungarian immigrant and his mother is of Greek-Jewish descent; his wife, Cécilia, is of mixed Spanish-Russian parentage. This outsider quality probably explains his determination to take on French tradition. “His handicap is heavy,” writes Nicolas Domenach in a recent biography. “No name nor fortune, no family connections, and even less an inherited fief. On the political right, if you have no inheritance, you need to be an *énarque*.”

But Mr Sarkozy is not an *énarque*. A former lawyer, he worked his way up through the party ranks in Neuilly, a smart suburb of Paris of which he became mayor. He is also of a different generation. Like Mr Chirac, 22 years his senior, he claims to champion ordinary folk—but policemen, firemen and supermarket shoppers, not the farmers of yesterday's France. And he loves being in front of the camera. While the Chiracs pose for *Paris-Match* seated stiffly in the Elysée Palace garden, the Sarkozys have their photos taken pounding the beach in jogging gear.

In short, if Mr Sarkozy's popularity outstrips both Mr Chirac's and that of other centre-right politicians (see chart 1), it is because he embodies something different. “The relationship between the French and Sarkozy is not one of affection, as it is with Chirac,” says Brice Teinturier, political director of TNS Sofres, a pollster. “Instead, it is one of intrigue and excitement.” The French do not warm to Mr Sarkozy, but they are impressed by his hyper-energy and determination to get things done. If Mr Chirac's France is fine just as it is, Mr Sarkozy's urgently needs to change. Who, though, is right?



The French paradox

The most devastating recent critique of the French model was delivered last month in a report by Michel Camdessus, a former head of the IMF, summarising the work of a 20-strong

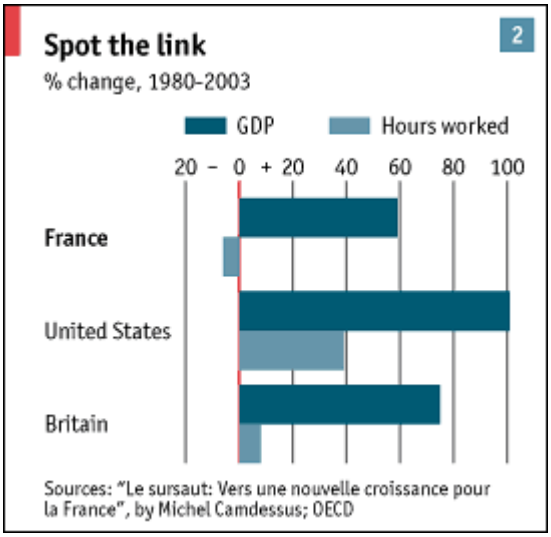
commission (set up by Mr Sarkozy when he was finance minister) of the French great and good:

> We are in a paradoxical situation. On a world scale, France is a rich and prosperous country, its standard of living among the highest. Our companies perform remarkably well. Our labour force is one of the most highly qualified. The quality of our infrastructure and our public services is envied the world over...But the world is changing, and certain mechanisms of our growth in the past have today worn out. Without a change of direction, decline is a real threat.

The strengths of the French economy are impressive. Its private sector boasts leading firms that, among other things, wash the world's hair (L'Oréal), insure its homes (AXA), inflate its tyres (Michelin) and clothe its women (Louis Vuitton). For each hour worked, the French are 5% more productive than the Americans. Their economy has outperformed Germany's over the past six years. The French live long, healthy lives and, to the annoyance of Anglo-Saxon theorists, seem happy to boot.

The main flaws, as the Camdessus report points out so crisply, are twofold. First, not enough people work, and those who do fail to work long enough; second, the heavy state has become a costly drag.

For 20 years, France's unemployment rate has been stuck between 8% and 10%. The young and the (not so) old are largely shut out of work. The employment rate among under-25s is now just 24%, where the OECD average is 44%, but that of 55-64-year-olds is 34%, compared with 50% in other OECD countries. Between 1980 and 2003, the total number of hours worked in America jumped by 39%, and in Britain by 8%; in France, it fell by 6%. This by itself almost entirely explains the differing economic growth rates over the same period in these three countries (see chart 2).



This, it could be argued, is a simple political choice: the French would rather have more leisure time than faster economic growth. But this is not a choice, Mr Camdessus retorts, for the 10% who are unemployed. The French model has not sheltered its people from poverty as sturdily as is often claimed. Despite devoting 30% of its GDP to social spending, among the highest shares in Europe, France's poverty rate (after social transfers) is not much below that in Britain, and is higher than in Finland or Sweden. Young people, unqualified and often Muslim, are isolated in the grim tower blocks that ring France's cities, which are becoming fertile recruiting grounds for radical Islam.

Some elements of the French public sector are efficient, but not all. The state spends 54.7% of GDP, compared with 44% in Britain. Too many people, filling in too much paper, enforcing too many rules and extracting too many taxes; the system is unsustainably piling up debt for future generations.

A heavy price is paid in job creation, too. High non-wage employment costs, coupled with tight redundancy rules, mean that companies make do with small payrolls. If hotels and restaurants employed proportionately as many people in France as they do in America, says the Camdessus report, the country would create 3.2m extra jobs overnight—albeit the sort of low-paid "McJobs" at which French governments tend to sneer. Over-protection of permanent jobs has prompted employers to recruit increasingly on precarious short-term contracts: these now account for over three-quarters of new jobs created. This two-tier job market particularly traps the young and low-skilled.

The upshot over the next ten years, argues the report, is that, as demographic pressures build, the potential yearly growth rate will fall from 2.25% to 1.75%. If, on the other hand, the employment rate was improved, the tax burden reduced, the labour market deregulated and more jobs created, the yearly rate could reach 3%. It is, in short, a prize worth striving for.

Mr Chirac's government has not sat wholly idle in the face of these challenges. His prime minister, Jean-Pierre Raffarin, has pushed through partial reforms of both state pensions and health insurance, and eased the 35-hour work rules a bit. Yet Mr Chirac defends the underlying model. “Do we need a liberal revolution in France?” asks one aide: “No; the state has always played an important role, and that is not a problem.” Mr Camdessus's report, in other words, has been met with polite silence.

Would Mr Sarkozy really be different? History hints at his motivation. From that precocious start in Nice, he was admitted into Mr Chirac's political and social orbit. (Mr Sarkozy was a witness at the marriage of Mr Chirac's daughter, Claude.) The split came when Mr Sarkozy ditched Mr Chirac to back Edouard Balladur in 1995. Mr Chirac did not speak to him for three and a half years, and Mr Sarkozy was cast into the political wilderness. “I have never considered Jacques Chirac as a friend, in the familiar sense of the term,” he wrote in his book “Libre” (“Free”) in 2001, “and the reverse is undoubtedly just as true.”

His years spent *dans le placard*, as the French put it, from 1995-2002, were formative. They gave Mr Sarkozy, as one adviser admits, “a hunger for power”. But they also mellowed him, helping him to soften his abrasive image. By the time he became interior minister in 2002, he was bursting to put his new thoughts into practice. His gravity-defying popularity dates exactly to that time (see chart 1).

Mr Sarkozy's strategy is based on action and communication, shot through with energy. In this post-ideological age, Mr Sarkozy—like Tony Blair or Bill Clinton, both of whom he admires—prefers inventive, tailor-made solutions over lofty visions. As he says, “I do what works.” Although he is happy in Britain or America to label himself “liberal”, he is careful to avoid the term in France, where it suggests extreme libertarianism. As one of his advisers puts it: “You can't preach open markets and get elected in France.” In the presidential system, a candidate in the run-off needs to appeal to the centre: he cannot afford to appear to come from the ultra-liberal right.

Markets and coercion

What does Mr Sarkozy really believe in? “Openness, suppleness, and letting citizens make their own choices”, is how he summed it up in “Libre”. In his seven months at the finance ministry, he pushed for an overhaul of the 35-hour week; trimmed the budget deficit to below the EU's 3% limit (though resisting deep spending cuts); reduced taxes on inheritance; sold stakes in various state enterprises, and set Electricité de France, against union resistance, on its way to privatisation.

Yet, in practice, Mr Sarkozy makes use of coercion as much as markets to get results. To reduce supermarket prices, for instance, he summoned grocers to a meeting and forced them to agree to price cuts on breakfast cereal and soap. To save jobs at Perrier in France, he persuaded its Swiss parent, Nestlé, not to sell this loss-making subsidiary. To create a French-flavoured national champion, he tried to bully EADS and Thales, two defence companies, to merge. His liberalism has limits not only in industrial policy. It is hard to see him taking on France's farm lobby. As interior minister, he clamped down on both prostitution and immigration.

Does this all add up to incoherence? His advisers argue that, while Mr Sarkozy does believe in a strong industrial policy, such views are also tactical: they give him the credibility to impose free-market solutions elsewhere. His economic adviser, after all, is a Harvard-trained free-marketeer. Mr Sarkozy considers the Camdessus report as a sort of manifesto. His supporters include Ernest-Antoine Seillière, the liberal head of the employers' federation. But this is France. “He's not from the school of Ricardo or Smith or Hayek,” says an aide, “His first school is pragmatism.”

This prompts unorthodox suggestions in other areas, too. Mr Sarkozy sounds most animated when railing against France's failure to ensure the social mobility of ethnic minorities. He links this failure to the growing appeal of radical Islam. Against prevailing wisdom, he co-opted hard-talking Islamists into a new official Muslim body. Against secular tradition, he suggests allowing public finance for mosques, to cut French Islam off from foreign sponsors. At the UMP, a flurry of other controversial ideas—affirmative action for ethnic minorities, curbing benefits to restore a culture of work—is promised.

Mr Sarkozy's hyperactivity suggests that he has the energy to pursue all this. But do the French want it?

France's politicians are paralysed by the experience of Mr Juppé, who as prime minister backed down from reform in 1995 after the French took to the streets. How can anybody get elected promising painful change?

Mr Sarkozy's answer is that the French will accept reform, if it is explained honestly and presented as in their interests. Advocacy, after all, is his profession. He likes nothing more than taking on a room of hostile unionists, and he has a heroic belief in his own powers of persuasion.

All of which promises tempestuous, possibly dirty, politics, and uncertain policymaking in the months ahead. After nearly ten years of Mr Chirac, Mr Sarkozy's electoral pitch relies ever more on distinguishing himself from his former mentor. For his part, Mr Chirac may well try to counter the threat by replacing the loyal but unpopular Mr Raffarin. Dominique de Villepin, the former foreign minister, now at the interior ministry, is the most likely candidate. Should Mr Chirac decide not to stand again in 2007, Mr de Villepin—a fellow neo-Gaullist—is also the man he is most likely to mould as his successor.

And on the left...

The victory of the right in 2007 is by no means certain. On the contrary, the left is well ahead in the polls, and crushed the right in the recent regional and European elections. Yet the Socialist Party faces its own internal power struggle: on December 1st, members will vote whether to back Laurent Fabius, the party's number two, in his call to reject the European Constitution against the wishes of François Hollande, the party boss. The absence on the left of a single natural candidate will test the electorate's current leftish sympathies.

The manufacture of presidents is a curious business in France. In the fifth republic, there have been only five, and two—Mr Chirac and Valéry Giscard d'Estaing—are still active. Mr Chirac had been in politics for 28 years before the French would elect him. Like Mr Sarkozy, he had formerly quit government to lead a political party. Like Mr Sarkozy, he once had a restless ambition, preternatural energy and—yes—a reputation for liberalism. Yet it was not until the agitated young man grew into a more conservative, paternalistic figure that the French backed him.

“To be a Gaullist is to be a revolutionary,” is a standard Sarkozy line. But in today's France, radicalism, let alone modernity, is not self-evidently a virtue that the electorate values. Mr Sarkozy may be ready for the French. But are the French ready for Mr Sarkozy?

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Education

Who needs a bad teacher when you can get a worse judge?

Nov 25th 2004 | NEW YORK
From The Economist print edition

The courts are making a mess of America's schools

Get article background

ONE reason that America's public schools do badly in international rankings, despite getting more money, is that nobody is really accountable for them. The schools are certainly not run by Washington: the federal government pays only 8% of their costs. Most of their money comes from state and local government, but often responsibility for them lies with school boards. And within the schools themselves, head teachers usually have little power either to sack bad teachers or to expel rowdy pupils.

Until recently, the main villains of the piece had seemed to be the teachers' unions, who have opposed any sort of reform or accountability. Now they face competition from an unexpectedly pernicious force: the courts. Fifty years ago, it was the judges who forced the schools to desegregate through *Brown v Board of Education* (1954). Now the courts have moved from broad principles to micromanagement, telling schools how much money to spend and where—right down to the correct computer or textbook.

Twenty-four states are currently stuck in various court cases to do with financing school systems, and another 21 have only recently settled various suits. Most will start again soon. Only five states have avoided litigation entirely.

Nothing exemplifies the power of the courts better than an 11-year-old case that is due to be settled (sort of) in New York City, the home of America's biggest school system with 1.1m students and a budget nearing $13 billion. At the end of this month, three elderly members of the New York bar serving as judicial referees are due to rule in a case brought by the Campaign for Fiscal Equity, a leftish advocacy group, against the state of New York: they will decide how much more must be spent to provide every New York City pupil with a “sound basic” education.

The idea that the state must provide a “sound basic” education was laid down by New York's Court of Appeals in 1995. At first blush, the term sounds obvious and modest. In practice, it is anything but. The New York courts have since said that schools must provide an education that gives “the intellectual tools to evaluate complex issues, such as campaign-finance reform, tax policy and global warming”. This is a standard most congressmen probably could not meet.

Trying to guess the amount of extra money the court will mandate has virtually become an industry in itself. State officials think the schools may need a top-up of $2 billion-5 billion a year; others say twice as much. Seeing that both the city and the state have large budget deficits, that will mean uproar (already there is talk of introducing slot machines to help meet the cost), followed by a fresh burst of litigation. The state and the city will also fight over who should contribute what to the settlement. Needless to say, talks with the teachers' unions have also stalled, as the unions wait to see how much extra money they can get for their members.

What is going on? *Brown v Board of Education* concerned a fundamental principle of racial equality. Although the current cases often refer back to *Brown*, they are to do with the far more complex issues of social class and educational excellence.

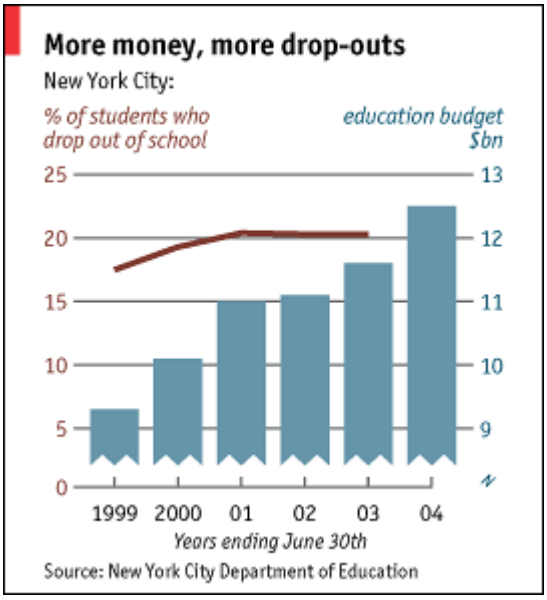
Traditionally, American schools have been funded by local property taxes, which inevitably meant that richer areas ended up with more lavish schools. In the 1970s, social reformers launched lawsuits to force states to equalise spending between rich and poor districts. Most were unsuccessful: the courts did not think they could mandate equality. But this changed in 1989 with a Kentucky case, *Rose v Council for Better Education*, where the court decided that education in poor school districts was inadequate, rather than merely unequal. The Kentucky court set specific standards that the children in state schools must reach.

In the wake of *Rose*, similar cases were brought across the country. In New York, the Campaign for Fiscal Equity seized on the phrase “sound basic” education, which had ironically been used by a state court in an earlier decision denying an attempt by Levittown, a Long Island school district, to equalise funding across the state. The case of *Campaign for Fiscal Equity v State of New York* was launched in 1993; so far, most of the decisions have gone the plaintiff's way.

Laying down the law

Rare is the politician willing to argue that more money for schools is a bad thing. But are the courts doing any good? Two suspicions arise. First, judges are making a lazy assumption that more money means better schools. As the international results show, the link between “inputs” and “outputs” is vague—something well documented by, among others, the late Senator Daniel Patrick Moynihan of New York. Second, the courts are muddling an already muddled system. Over time, they have generally made it harder to get rid of disruptive pupils and bad teachers.

New York illustrates both these points. Back in the 1980s, Kentucky ranked 48th among states on spending for each child. But New York City spends, on average, more on each child than the average in any state with the exception of Connecticut, and more on average than the next 30-odd largest school districts. Despite this, New York City does not have good schools: more than half its pupils in grades three to eight fail to meet the city's standards for maths or English, a fifth of its high-school pupils drop out, and its buildings are falling to pieces.



As for complexity, back in 1979 the city was successfully sued for failing to meet the needs of a severely handicapped pupil. This well-intentioned litigation has since mushroomed into a vast, court-directed “special education programme” with 172,000 children, very few of whom are handicapped as badly as the original plaintiff. To satisfy its requirements, the court lays down innumerable mandates, rules and reporting requirements that are the bane of many teachers' lives.

The current case could be even worse. The courts have already said that, in order to determine the necessary spending, they may consider everything from class size to the availability of computers, textbooks and even pencils. This degree of intervention is all the more scandalous because the courts have weirdly decided to ignore another set of “inputs”—the archaic work practices of school teachers and janitors. David Schoenbrod and Ross Sandler of New York Law School reckon the demands of the court will simply undermine reform and transform an expensive failure into a more expensive one.

And of course, the litigation never ends. Kentucky, for example, is still in court 16 years after the first decision. A lawsuit first filed against New Jersey for its funding of schools in 1981 was “decided” four years later—but it has returned to the court nine times since, including early this year, with each decision pushing the court deeper into the management of the state's schools. Bad judges are even harder to boot out of school than bad pupils.

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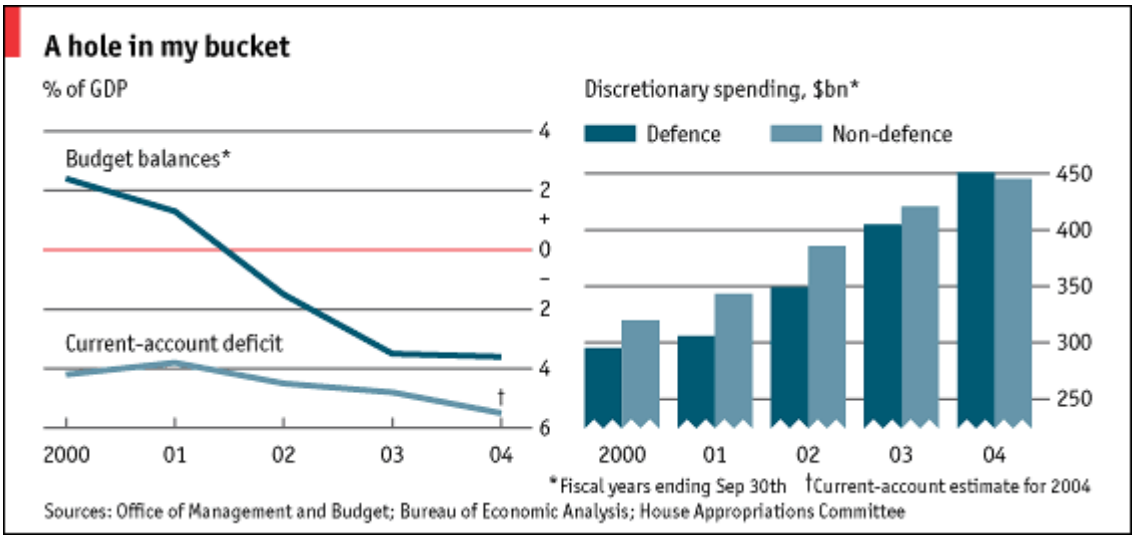
The economy

A series of fortunate events

Nov 25th 2004 | WASHINGTON, DC
From The Economist print edition

The sliding dollar could help to redress America's economic imbalances. But don't count on a smooth ride



Get article background

CONVENTIONAL wisdom holds that George Bush's first-term team could not create jobs and did not care about deficits. Less than a month after the presidential election each of those views needs adjusting. With 337,000 new jobs in October, more than twice as many as analysts predicted, the supposedly “jobless” economy is looking decidedly perky.

Meanwhile, far from dismissing deficits, America's economic policy-makers are suddenly talking about little else. On November 17th, John Snow, America's treasury secretary, argued in London that America's fiscal deficit was his “most pressing issue”. And Mr Bush himself claimed that America was “committed to deficit reduction, both short-term and long-term”. In Frankfurt on November 19th, Alan Greenspan, chairman of the Federal Reserve, endorsed the new emphasis with uncharacteristically pointed comments about America's current-account deficit, now 5.7% of GDP and rising. Given the size of the imbalance, he argued, “a diminished appetite for adding to dollar balances must occur at some point,” before making clear that reducing the budget deficit should be part of the way out.

Right on cue, Congress passed a surprisingly frugal spending bill on November 20th. The bill allowed for a growth rate of only 1% in discretionary spending outside defence and homeland security, the lowest figure in almost ten years.

If you think unexpected economic strength and unexpectedly prudent political rhetoric sound too good to be true, you are probably right. America's economy faces some big, possibly painful adjustments over the next four years.

The most striking economic news since the election has been the dollar's slide. Since November 2nd, the greenback has fallen steadily and this week hit new lows against the euro and several Asian currencies (see article). Foreign investors are finally fretting about America's imbalances.

The surprise is that this has not happened before. America's current-account deficit is in uncharted

territory, both as a share of the economy and in terms of the share of foreign savings it soaks up. Most economists have long argued that this imbalance must, at some point, be corrected. That could come through greater demand outside America; or slower demand within America (implying higher saving and/or lower investment); or a continued downward slide in the dollar.

In public, the Bush team talks up foreign growth, domestic fiscal prudence and a strong dollar. Their real view, however, seems to be that much of the adjustment will come through a weaker dollar.

Look at the evidence to date, and you can hardly blame them for thinking this will be painless. The dollar has slid, but there has been no painful financial crash, no dramatic rise in long-term interest rates, no perceptible impact on America's asset markets (the Dow Jones Industrial Average is up almost 5% since the election). Equity and bond markets did dip a little after Mr Greenspan's recent comment; but Wall Street seems to share the Bush administration's sanguine view.

Can this continue? Economic theory suggests not. Sooner or later, a sliding dollar should bring higher interest rates, both because skittish foreigners will demand higher returns to hold dollar assets and because investors of all sorts will demand a premium for the inflationary risk that a depreciating currency implies.

In addition, there may have been special forces pushing down interest rates. Most obviously, those altruistic Asian central banks have bought vast numbers of American bonds. But dampened expectations about America's economy have also helped: the surge in oil prices prompted concerns that the economy would stay soft, pushing down long-term interest rates. Finally, the central bank's decision to raise short-term rates four times since June has bolstered confidence that Mr Greenspan will not let inflation get out of hand, thus taking pressure off long-term rates.

A note of realism

These special circumstances may not last. Asian central bankers may lose their enthusiasm for treasury bonds. Far from feeling gloomy, America's economy is looking resilient—as the recent jobs figures showed. Firms are flush with cash and investing more. Both producer and consumer prices soared in October. To be fair, the headline figures owed much to oil prices and hurricane-related supply shocks. But even if you take out the volatile categories of food and energy, “core” consumer-price inflation rose at an annual rate of 2.3% between August and October. With productivity growth slowing and wages firming, unit-labour costs have begun to rise following two years of decline. Meanwhile, by pushing up import prices, the dollar's depreciation will increase inflationary pressure.

Add these factors together and it seems likely interest rates are headed higher. If any such rise were modest, it would bother no one in Mr Bush's team; it would be interpreted as a sign of economic vigour and an inducement to more private saving. But a big slide in the dollar might force interest rates to rise far more sharply than anyone expects, causing serious problems both for the frothy housing market and the debt-laden consumer.

This explains Mr Bush's sudden interest in fiscal prudence. Not only is bringing down America's budget deficit a direct route to higher national saving and thus to reducing the current-account deficit. Signs that America's huge budget deficit was being brought under control would also calm those skittish foreigners (and so control the dollar's slide) as well as reassure the bond markets. Both these things would reduce the chances of an unpleasantly sharp rise in long-term interest rates.

The short-term budget outlook is a lot better today than even a couple of months ago, largely because tax revenues have risen surprisingly fast. At 3.6% of GDP, the budget deficit for the fiscal year that ended on September 30th was smaller than expected. Provided the economy hums along, revenue growth could push the deficit to around 2.5% within the next couple of years, as long as spending is kept under control. The recent spending bill is a welcome, if small, step in that direction. Next year will bring tougher battles, such as the five-year transportation bill, a favourite for lawmakers to pack with pork.

But even if revenues hold up and discretionary spending is controlled, Mr Bush's goal of halving the deficit by 2008 looks tricky. His calculations do not include political imperatives such as fixing the Alternative Minimum Tax (see article) or reforming Social Security. Any diversion of pay-roll taxes into individual pension accounts would have to be covered by government borrowing. Administration officials plead that this would simply be an accounting change—turning implicit liabilities (promises to pay future pensions) into explicit liabilities (government bonds). It is far more likely that the bond markets would

treat a wave of Social Security bonds as fresh American government borrowing. That would not endear foreign investors to the dollar.

There is a virtuous circle there: if you combine a fiscal adjustment with a rise in Americans' private saving, a sizeable but controlled decline in the dollar and faster growth abroad, Mr Bush could reduce his country's imbalances with relatively little pain. Unfortunately, there are a worrying number of things that could go wrong.

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About sponsorship

Louisiana politics

My dad wants you to elect me

Nov 25th 2004 | NEW ORLEANS
From The Economist print edition

Steamy stuff in the South—and more gains for the Republicans

AP

ANYONE who decided that the main presidential electoral dinner was rather tame should perhaps pop down to Louisiana for a nightcap. Under the state's unusual election system, all congressional candidates run in open primaries on Election Day. Unless one gets more than 50% of the vote, the top two finishers meet in a run-off. And that's where the action is really getting under way in two congressional districts in Huey Long's home state.

Take, for instance, one recent ad showing a young boy romping around absurdly in a man's business suit. The words “little Billy Tauzin” appear on screen in colourful, clownish lettering.

As everyone in Louisiana's swampy third congressional district knows, Billy Tauzin III is the 30-year-old son of Congressman Billy Tauzin junior, the former House Energy and Commerce Committee chairman, who is now retiring. Though criticised by Yankee consumer groups as a shill for broadcasters and the Baby Bell phone companies, the elder Mr Tauzin is beloved in Louisiana for his charm, legislative mastery and pork-procuring abilities. The resumé of the younger Mr Tauzin (who is also a Republican) is considerably shorter. Before getting a job as a lobbyist for BellSouth, “Little Billy” sold cellular phones at a shopping mall in Virginia.

Helped by his name, Mr Tauzin led the field on November 2nd (with 32% of the vote), followed by Charlie Melancon, a former state legislator and sugar lobbyist (24%). Mr Melancon's campaign was commonly considered to have started out dull; the little Billy Tauzin ad is a sign that the Democrat is at last warming up for the run-off on December 4th, but for now most of the smart money is still on Mr Tauzin.

Painting the state red

Mr Tauzin's family connections aren't the only thing working in his favour. The Republicans are on a roll in Louisiana. Indeed, they also expect to win the other congressional run-off in the seventh district, where Charles Boustany, a former heart surgeon, should fend off Willie Mount, a Democratic state legislator.

The Democrats, who used to dominate the state in Long's day, have had a lousy year. In August, one of their few remaining congressmen, Rodney Alexander, who had only sneaked into the House in 2002 on the strength of a massive Democratic get-out-the-vote drive for Senator Mary Landrieu, abruptly switched parties on the final day of qualifying. Indignant Democrats had no time to find a suitable candidate, and the freshly Republican Mr Alexander waltzed home.

By contrast, in the race to replace John Breaux, their popular retiring senator, the Democrats ignored attempts to rally round Congressman Chris John. Two other Democrats joined the fray, whilst the Republicans fielded Congressman David Vitter. A staunch conservative on most issues, Mr Vitter softened his image with ads that portrayed him as a flustered dad. Buoyed by George Bush's popularity, he won 51% in the primary and will be the state's first Republican senator since Reconstruction.

Despite these setbacks, Democrats are still far stronger in Louisiana than elsewhere in the South. Ms

Landrieu hung on to her Senate seat two years ago, and last year, Kathleen Blanco won the governorship even after finishing a distant second in the primary. Most statewide elected officials belong to the party, as do most state legislators, sheriffs, assessors and other local officials.

Yet many of these politicians—including the party's two congressional run-off candidates—would be unrecognisable as Democrats in Boston or Berkeley. Ms Mount, for instance, opposes abortion and has an "A" rating from the National Rifle Association. Mr John supported cockfighting, which encouraged animal-rights groups to run ads against him (hurting him among suburban women).

In their attempts to woo white conservatives, the Democrats often alienate blacks (who make up a quarter of the electorate). In the seventh district primary, leading Democrats pushed for the white Ms Mount over Donald Cravins, a black state legislator. He has declined to support Ms Mount in the run-off and is threatening to sue the party for taking sides.

Part of the problem for the Democrats may be the open primary itself, which was designed in the days when "Louisiana Republican" was an oxymoron. But because voters seem to like the system, changing it would be difficult. Even if Mr Melancon and Ms Mount win, the faster-growing areas of the state—the newer suburbs around Baton Rouge and New Orleans—are Republican strongholds. It will take more than clever ads or party discipline to keep Louisiana Democratic.

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Brawling basketballers

Definitely out of bounds

Nov 25th 2004 | WASHINGTON, DC
From The Economist print edition

An inevitable tale of beer, chairs, fans, fists and the occasional erection

AP

Run: there's a puritanical role model on the loose

OVER and over, the sorry scene has been repeated on American television sets. A basketball game between the Indiana Pacers and the Detroit Pistons last week ended abruptly when a fan threw his drink at a Pacers player. The player, Ron Artest, leaped into the stands to seek revenge. Fans hurled more drink. Several other basketballers joined in, and a massive punch-up ensued. Someone chucked a chair.

On November 20th, the National Basketball Association suspended nine players without pay. Mr Artest is gone for the rest of the season, the harshest penalty in basketball history. Injured fans are filing lawsuits, and criminal charges could follow against both players and fans.

Americans everywhere profess shock. Rarely, they insist, do scraps between players and fans get this bad. “No more making fun of European soccer hooliganism,” noted a Texan in a web posting on ESPN, America's main sports network. Teachers worry that schoolboys, who spend their evenings and weekends watching games and playing “fantasy” sports, the newest internet rage, will have their minds poisoned by the recent violence.

Please. To begin with, dust-ups are a regular feature of American sport. The baseball rivalry between the Boston Red Sox and the New York Yankees has long been cemented by the occasional bench-clearing brawl. Last week the basketball bleachers were not the only place where scuffles broke out. A college-football game between South Carolina and Clemson, fierce rivals, dissolved into fisticuffs

As for the idea that American sports stars are puritanical role models, this beggars belief. Almost the only perfect thing about the athletes in question is their bodies—and those have often been pharmaceutically enhanced. Barely a year goes by without episodes of rape, pillage and even murder—all the inevitable result of too much money colliding with too few brains. If the sins of sports stars were limited merely to clobbering the odd fan, then Court TV would be out of business.

As anyone who reads the British tabloids can explain, badly behaved sportsmen are a global phenomenon. So are churlish fans: last week Spanish ones hurled racist insults at black English soccer-players. What is odd about America is that sports are played out in macho conditions not seen since the Coliseum. Most spectacles come down to hyped-up young men mauling each other in front of beer-guzzling fans and scantily clad cheerleaders, while coaches yell abuse.

As for those supposedly offended advertisers, the more benign commercials nowadays promote beer. Others peddle Cialis and Viagra and advise anyone having an erection lasting four hours to see a doctor: try explaining that to a fifth-grader.

Inconsistency is rife. Cialis and on-field tussles may go down without much fuss. But the National Football League, guardian of America's most popular sport, threw a fit about the “wardrobe malfunction” during the half-time show at the Superbowl, when Justin Timberlake ripped the bodice of a fellow singer, Janet Jackson, exposing a breast. Now there is a fuss about a pre-game commercial for “Desperate Housewives”, a television hit: it depicted a Philadelphia Eagle player gladly agreeing to skip the game after seeing one such housewife drop a towel she was wearing. But never mind: another round of apologies, and Middle America's churchgoing fans will settle back in front of the tube, ready to be shocked by the next scuffle.

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The San Diego mayor's race

Surfer chick makes waves

Nov 25th 2004 | SAN DIEGO
From The Economist print edition

The Democratic loser exposes the darker side of "Enron-by-the-Sea"

Hilary Thomas

We will fight them on the beaches

DICK MURPHY, seeking re-election as mayor of San Diego, had expected a repeat of the 2000 election, a two-man run-off on November 2nd with county supervisor Ron Roberts—"two white male moderate Republicans in their early 60s". Instead he has ended up losing the headlines in a three-way fight to the Democrats' Donna Frye, a 52-year-old sun-bleached blonde surfer-turned-activist councilwoman and open-government campaigner whose frequent campaign aide was a shaggy-haired dog called Diogenes.

Has Mr Murphy, a former judge, lost the election, too? Probably not, following a judge's decision on November 22nd.

The background to the confusion is that Mrs Frye had spurned the non-partisan March primary ("At that time I really didn't want to be mayor—it was a gut feeling"), and had declared her candidacy only at the end of September. That was too late for her name to be on the ballot paper. So the famed "surfer chick" invited her supporters to write her name in. More than 155,000 voters obliged.

That put her comfortably above the haplessly grey Mr Roberts and just a couple of thousand votes behind the courteous but equally grey Mr Murphy. That still leaves another group of ballot papers—supposedly 4,000 of them—which carry her name but where the voters failed to mark the necessary "bubble" (or box). This week, Judge Eric Helgesen decided they could not be counted.

Mr Murphy is not quite out of the woods. The city registrar has until November 30th to certify the results. Mrs Frye's supporters may still appeal. Others are challenging the legality of a write-in candidate in the first place (the city charter makes no mention of a write-in, though the municipal code does). If they succeed in the courts, Mr Roberts could presumably demand a rematch.

Leaving the ifs and buts to the lawyers, Mr Murphy has already declared victory. But the triumph is hardly convincing. How did San Diego get itself into this electoral mess in the first place?

Republican business types speak darkly of organised labour and its well-timed backing for Mrs Frye. San Diego's reputation as a Republican stronghold—Pete Wilson, California's last Republican governor before Arnold Schwarzenegger, was three times its mayor—is now more myth than reality. Though Republicans rule the roost in San Diego County, the city itself has a Democratic majority who, in the presidential election, gave John Kerry a 12-percentage-point victory over George Bush. Most of the nine-member city council are Democrats.

A better explanation is that the political establishment is being punished for its own incompetence and perceived corruption. In August last year, for example, three councilmen were indicted on charges of accepting bribes from a strip-club owner enlisting their help to change a "no touching" law. More damagingly, the FBI, the Justice Department and the Securities and Exchange Commission are investigating a pension-fund scandal that led the *New York Times* to label the staid city "Enron-by-the-Sea".

The scandal is not just that the city has allowed its unfunded pension liability to reach almost $1.2 billion

(a 32% shortfall), plus a shortfall of $545m for retirees' medical benefits. It is that the council either knew or should have known about the deficit—but chose to ignore it until the determined whistle-blowing of a pension-fund trustee forced Wall Street to cancel a bond issue for the city last year.

Mr Murphy rightly notes that the seeds of this current embarrassment were sown long before he came to office. In 1980, for example, the city used above-average returns on its investments not to build up a reserve but to give bonuses to pensioners who would otherwise have been hit by above-average inflation. Then, in 1996, the cash-strapped city chose to cut its pension contributions, whilst simultaneously promising increased pension benefits.

A bad election to win?

The city repeated this trick on Mr Murphy's watch in 2002 (despite the asset-lowering effects of the dotcom collapse). By contrast, Mrs Frye, often a lone voice in council decisions, opposed the 2002 pension vote, just as she did a generous new stadium lease for the San Diego Chargers.

Mr Murphy's planned remedy for the pension crisis includes a two-year salary freeze for the city's 11,000 employees, extra contributions to the pension fund and a general retirement age of 62 rather than the present 55. And (providing his election holds), he will be publicly identified with the pain: whereas previously the mayor of San Diego was merely first among equals on the city council, now a successful ballot measure will make him the city's powerful chief executive, with the authority to hire and fire city officials.

And what of the apparently defeated Mrs Frye? Invoking the wisdom of her husband, “surfer legend” Skip, she says with a smile: “It's sort of like the surf. You have good days and you have bad days.”

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Lexington

Dropping the anchorman

Nov 25th 2004
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Dan Rather's retirement marks a welcome change in American journalism

FOR conservative America, it just keeps on getting better. A mere 20 days after the Republicans' clean sweep of the White House and Congress, the American right celebrated the retirement of one of the hated grandees of liberal journalism, Dan Rather. “It's as if the voters just keep on voting,” says one conservative. “And our side just keeps on winning.”

The right has been after Mr Rather's scalp for decades. The CBS veteran made his name beating up Richard Nixon in the Watergate era and has kept CBS News on the liberal straight-and-narrow as its longstanding news anchor. (Accuracy in Media, a conservative-watchdog group, first started its “Can Dan” campaign 16 years ago.) Mr Rather's career highlights include a shouting match with George Bush senior over Iran-contra and an interview with Saddam Hussein shortly before last year's American invasion. Now the 73-year-old has announced that he will be retiring from his anchoring job next March.

Next March will be exactly 24 years since Mr Rather took over from Walter Cronkite. But Mr Rather's reputation has not recovered from a “60 Minutes” documentary (made by CBS) which tried to raise questions about George Bush junior's service in the Texas National Guard. Mr Rather claimed to have documents proving that Mr Bush had violated a direct order to take a physical examination, and also that his superiors had been put under pressure to “sugarcoat” his evaluation. But within 14 hours internet sleuths had shown that the documents were forgeries. Mr Rather stood by his story for 12 excruciating days, while his supporters arrogantly contrasted the network's rigorous fact-checking with “a guy sitting in his living room in his pyjamas writing”. But the pyjama guy turned out to be right.

Mr Rather's retirement epitomises two broader shifts of power. First, the old media are losing power to the new. And, second, the liberal media establishment is losing power to a more diverse cacophony of new voices.

For most of the post-war era the American media were dominated by a comfortable liberal consensus. The *New York Times* was the undisputed king of the print news, while the network anchors lorded it over TV news. That consensus is now under siege. The attacks are partly coming from the cable networks—particularly from conservative Fox News. (Charles Krauthammer once quipped that Rupert Murdoch had spotted a niche market—half the country. Sure enough, Fox is now America's top-rated cable news network.) But old media also face a newer and more unpredictable source of competition—the blogosphere. Bloggers have discovered that all you need to set yourself up as a pundit is a website and

an attitude.

All through the recent election campaign, the new media outsmarted the old media when it came to setting the news agenda. Republican strategists admit that the Swift Boat veterans' attacks on John Kerry, largely ignored by the old media, would never have got anywhere without the online *Drudge Report*. *Drudge* was also instrumental in turning the “60 Minutes” story into an embarrassment for the Democrats, not Mr Bush. Local bloggers also had an effect; in South Dakota, for instance, they repeatedly highlighted Tom Daschle's partisan record in Washington, DC, something that the Democratic Senate majority leader's friends in the local print media had never laboured to expose.

The bloggers have often been at their most devastating when they have been criticising the old media for bias. Their favourite target has long been the *New York Times*, where they helped to remove the paper's previous editor, Howell Raines. But CBS is also a juicy target. Why, the bloggers are now demanding, is Mr Rather being allowed to keep a full-time job working for “60 Minutes”, the very programme whose reputation he has besmirched? “This is not a victory,” proclaims Rathergate.com, before declaring its intention to keep attacking CBS.

I'd rather not be Rather

Given America's fractious politics, it is easy to look at Mr Rather's retirement merely in terms of a left v right scorecard. But, more fundamentally, it is about choice.

Mr Rather's announcement of his (partial) retirement comes just a few days before Tom Brokaw resigns from his job anchoring NBC's evening news. That leaves ABC's Peter Jennings as the only survivor of the long-established triumvirate. But nobody imagines that the arrival of new blood at CBS and NBC will revive the fortunes of the network news. Most Americans now get their news from an ever-proliferating range of sources: not just Fox or CNN, but also foreign newspapers and even the innumerable original documents that are now available at the touch of a button. And fewer people regard any single news source—be it CBS News or the *New York Times*—as the embodiment of truth.

The erosion of the old media establishment probably does entail some shift to the right, if only because so many of the newer voices are more reliably pro-Republican than Mr Rather. But the new media are simply too anarchic and subversive for any single political faction to take control of them. There are plenty of leftish bloggers too: such people helped Howard Dean's presidential campaign. And the most successful conservative bloggers are far from being party loyalists: look at the way in 2002 that they kept the heat on the Republicans' then Senate leader, Trent Lott, for racist remarks that the *New York Times* originally buried. It is a safe bet that, if the current Bush administration goes the way of previous second-term administrations and becomes consumed by scandals, conservative bloggers will be in the forefront of the scandal-mongering.

Mr Rather's passing does not mean that the liberal orthodoxy is about to give way to a new conservative one. It means that all orthodoxies are being chewed up by a voraciously unpredictable news media, which is surely all to the good.

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Brazil's armed forces

Resurrecting the right to history

Nov 25th 2004 | SÃO PAULO
From The Economist print edition

Agencia Estado

Having shrugged off the legacy of its military dictatorship, Brazil may now be forced to deal with it after all

IT STARTED as a case of mistaken identity about a naked man. Last month *Correio Braziliense*, a daily based in the national capital, Brasília, published photographs of a nude man sitting in a cell, head in his hands. The newspaper identified him as Vladimir Herzog, a journalist murdered by Brazil's military regime in 1975. The picture turned out to be of a Canadian priest, still very much alive. But by the time the farce had played itself out the defence minister had quit, the head of a commission on victims of the dictatorship had resigned and a dormant debate about Brazil's handling of its authoritarian past had reawakened.

Brazil's military regime, which governed from 1964 to 1985, was relatively mild and the country had apparently recovered fully. Some 300 enemies of the state, real and imagined, had been murdered, compared with 3,000 in Chile and at least 10,000 in Argentina, much smaller countries. But thousands were also tortured, jailed or exiled, or lost their jobs. Brazil's left-leaning government consists basically of survivors. The president, Luiz Inácio Lula da Silva, was imprisoned for leading strikes; his top aide, José Dirceu, was an exile in Cuba. As in most Brazilian revolutions, a new order emerged without overthrowing the old.

This is now the problem. The Herzog affair showed Brazilians that, while the armed forces accept democracy, they have not fully atoned for their past, that the victims of the dictatorship have had scant justice and that the government of former freedom fighters is at a loss for what to do.

The first shock was the army's response to the photos. Its public-affairs office issued a statement justifying military rule as a “legitimate response to [Communist-inspired] violence.” It was hastily withdrawn and a blander one issued. The second shock was that the government chose to punish not the army commander but the defence minister, who left denouncing “the persistence of authoritarian thinking” in the armed forces. He has been replaced by the vice-president, José Alencar, who now holds both jobs.

This curious episode has its origins in the way Brazil eased away from military rule without a final settling of accounts. The process began in 1979 when the presiding general of the time declared a reciprocal

amnesty, absolving both the regime and its opponents of their crimes. The armed forces never apologised, as the army did in Chile, nor did the government investigate their crimes and imprison generals, as Argentina's did. Brazil's dictatorship produced victims, but no culprits.

That gentle transition has served Brazil well. The armed forces have gradually accepted the democratic yoke (the post of civilian defence minister was not created until 1999). But the victims have had to content themselves with second-rate justice. Democratic governments have set up a tortuous process through which political prisoners and exiles, or their families if they have been murdered, can apply for compensation from the government. The rules are eccentric. Relatives of the dead get a one-time payment while persecuted workers, including President Lula, are entitled to handsome pensions.

And because compensation is the state's only way of saying sorry, justice has become entangled with the messy business of budgets and benefits. Stories of well-educated former dissidents set to become amnesty millionaires have sparked resentment, obscuring the justice of their claims. The government estimates its liability at 4 billion *reais* ($1.5 billion) and is now thinking of capping the awards.

In the absence of a national reckoning, victims are now pressing for the opening of archives shut by Brazil's previous president, Fernando Henrique Cardoso, who in his final days in office decreed a doubling of the secrecy period for classified documents. “We are demanding our right to the history of Brazil,” says Rose Nogueira, who was jailed and tortured in 1969 and 1970 and now heads the São Paulo chapter of Tortura Nunca Mais, an NGO.

Not all documents are secret. Lawyers for political prisoners surreptitiously copied and then published their testimony. States have a rich hoard, seemingly arranged to baffle scholars and victims seeking evidence. It was by accident that the family of Virgilio Gomes da Silva, who was arrested for kidnapping the American ambassador in 1969 and then “escaped”, came across proof this summer that police had possessed and identified his body.

But the sealed archives could reveal much more. Before they were briefly opened in the 1990s, people thought that torture was perpetrated by underlings who went beyond their orders, says Carlos Fico, a scholar who worked on them. “My analysis showed the responsibility of generals.” Sooner or later, he thinks, “Lula will have to open the archives.”

The government seems ambivalent. The president's top military adviser, General Jorge Armando Félix, gave warning in a newspaper interview that the archives contained embarrassing tales of philandering by the regime's opponents, a statement widely interpreted as attempted blackmail. Civilian officials are looking for compromise. The government will re-examine the sealing of the archives, said Nilmário Miranda, the human-rights minister, “taking care not to provoke resentments or crises, either political or military.” Yet it is now uncomfortably aware that there can be no final reconciliation without truth.

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Corruption in Costa Rica

Not so Swiss after all

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From The Economist print edition

Bribery scandals engulf Costa Rica

AFP

Putting Rodríguez on ICE

ON NOVEMBER 20th, Costa Rica was hit by a 6.2 magnitude earthquake. There was a handful of deaths, three from heart attacks. The quake also spiced up the end of an otherwise dull Ibero-American summit. “We jumped from the bed like two cats,” reported the wife of Panama's youthful president, Martín Torrijos.

That the quake did little worse than make the earth move under Mr and Mrs Torrijos was a relief to Costa Ricans. For they are currently preoccupied with another set of shockwaves, triggered by a series of financial scandals.

It has come as a mild shock to many Costa Ricans that their country has scandals at all. They like to think of themselves as a cut above their neighbours, seemingly mired in endless cycles of corruption and civil wars. By contrast, Costa Rica, which gave up its army and pioneered eco-tourism, is usually referred to, half-mockingly and half-enviously, as “the Switzerland of Central America”. So the fact that these scandals involve not just one, but all of the country's three most recent ex-presidents, has only deepened the self-doubt.

Two separate cases came to light at roughly the same time this summer, both involving bribes allegedly paid by foreign companies doing business with state-owned firms. Rafael Ángel Calderón, president from 1990 to 1994, is charged with distributing, and taking a share of, an illegal “commission” of about $9m connected to the supply of medical equipment by a Finnish company to the state health-care system, the CCSS. (It was a probe into the suspiciously lavish lifestyle of a CCSS official that led to the discovery.) Meanwhile, Miguel Ángel Rodríguez, president from 1998 to 2002, has been charged with accepting a share of a $2.4m payment that Alcatel, a French telecoms company, made in relation to a contract that it won from the Costa Rican state-owned telecoms and electricity firm, the ICE, in 2001.

Both ex-presidents plead innocence, but they have already been publicly humiliated, and sent to jail where they await trial. Mr Rodríguez also had to resign as the head of the Organisation of American States, just a fortnight after taking up the post. And attention has now shifted to a third ex-president, José María Figueres (1994-98), who has admitted receiving almost $1m from Alcatel as “consulting fees”.

He has already had to resign as executive president of the World Economic Forum in the real Switzerland, as the fees broke the terms of his contract. Costa Ricans are waiting to see when (or if) he will return from abroad to face a congressional committee anxious to question him.

Some 25 other people are being investigated in the government, the ICE and the CCSS. The local press—which has been happily pursuing the scandals, even publishing helpful maps showing how they all seem to be interconnected through the same small bunch of people—threatens more revelations.

All this makes Costa Rican politics more exciting, if unpredictable. The balance between the two main parties, the National Liberation Party and the ruling Social Christian Unity Party, has lent the country a political stability that is the envy of its neighbours. Now, however, some politicians have been leaving the tainted main parties—all three ex-presidents come from them—to form or join smaller minority ones. That, some fear, could make the political system more unstable.

Another worry is that the scandals might weaken investor confidence too. Costa Rica's reputation for relative transparency and order has brought in a lot of foreign capital in recent years, particularly in the high-tech sector. But there is still reason for optimism, argues Arturo Condo, an economist at INCAE, a local business school. The authorities' quick response once the scandals came to light and the alleged culprits' swift dispatch to jail shows, he says, an “independent judiciary at work” and a consensus in Congress that due process must be followed to the letter.

In any case, Mr Condo argues, what Costa Ricans are now seeing “is not the tip of the iceberg, but the iceberg itself.” They must hope so—for in this tropical Switzerland, icebergs are no more common a sight than politicians behind bars.

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An assassination in Venezuela

End of innocence

Nov 25th 2004 | CARACAS
From The Economist print edition

A prosecutor's murder unnerves Venezuela

Get article background

AFP

The people think they know whodunnit

THOUGH polarised and in political turmoil for the past three years, Venezuela has been remarkably free of the assassinations for which neighbouring Colombia is sadly notorious. But on the evening of November 18th, a small lump of carefully-placed plastic explosive put an end to that record—and with it, the life of a state prosecutor, Danilo Anderson.

The 38-year-old Mr Anderson had become a favourite of Hugo Chávez's "revolutionary" government. A former student radical, he had thrown himself with enthusiasm into high-profile cases against government opponents, including many relating to the coup attempt against Mr Chávez in April 2002. As a result, he was not short of enemies. "Half the population hates me," he told a newspaper interviewer not long ago. He died instantly when his car blew up and crashed into a shop-front, in what bore the hallmarks of a professional hit. Although there was also a recent apparent attempt on the life of General Jorge García Carneiro, the defence minister, there is no sign as yet of a link between the two.

The police investigation brought some early results—among them the mysterious death of a lawyer, Antonio López, in a gunfight with police who had tried to stop him in his car. They later claimed to have found explosives and detonators at his home. The interior and justice minister, Jesse Chacón, said that Mr López, who had done explosives courses in the United States, had had "the type of training received by the kind who are often linked to the CIA." But otherwise the official response has been fairly restrained, without the indiscriminate raids, suspension of constitutional guarantees, or revenge from pro-government extremists that some in the opposition had feared.

All the same, there are signs that Mr Chávez will use Mr Anderson's killing as an excuse to crack down further. He has long sought to brand many forms of opposition protest, including business stoppages, strikes and the paralysing of the oil industry in 2002-03, as "terrorism", thus blurring the distinction between a violent minority and the opposition as a whole. Now the government has promised an acceleration of "anti-terrorist" legislation which will punish peaceful protesters too. Leaders of Mr Chávez's party, the Fifth Republic Movement, have already proposed allowing judges and prosecutors to act anonymously, though officials have ruled this out. The head of the Supreme Court this week said that terrorism cases—once the new law provides a definition of terrorism, which could well be a vague one—will be tried by a select few courts. This may make them easier to lean on.

Moreover, Mr Chacón was not the only official to hint at a connection to the United States; others mentioned Florida-based anti-Castro Cubans. These may be little menace to anyone but themselves as they romp around the Everglades in combat gear and pose for photographs with assault weapons. But it is hard for Venezuelans of any political stripe to understand why the American government—so tough-talking on terrorism elsewhere in the world—allows their public threats to assassinate Mr Chávez to go unpunished. And that makes it even easier for Mr Chávez to draw the fire on to his enemies.

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AIDS in Jamaica

The fear that spreads death

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Anti-gay prejudice is contributing to the spread of AIDS in Jamaica

WHEN Brian Williamson, one of Jamaica's few openly gay activists, was stabbed to death last June, there was glee on the street outside his home. Gay men in Jamaica either stick fast to the back of the closet, often finding a woman for cover, or live openly and in fear. Human Rights Watch, a New York-based organisation, last week released “Hated to Death”, a report on homophobia, violence and Jamaica's HIV/AIDS epidemic. It makes chilling reading. Witnesses claim harassment and sometimes violence from a police force which should be providing care and protection. Laws that punish gay sex with up to ten years in prison set the tone. The Jamaica Police Federation responded robustly to the report: it wants the justice minister to “slap on sedition charges where necessary to both foreign and local agents of provocation”.

The Caribbean has the world's highest HIV prevalence after sub-Saharan Africa, with 2.3% of adults infected, according to a report released this week by UNAIDS. There are some successes: Barbados, the Bahamas and Bermuda have brought their infection rates down in recent years. Foreign groups help local NGOs, and allow many health-care systems to provide AIDS-treatment drugs free of charge; that now happens even in Jamaica. But drugs cannot be successfully issued or used in a climate of fear.

And fear there is aplenty. Powerful evangelical churches spread an unforgiving gospel; and while they promise sinners suffering in the afterlife, others are more than ready to offer it in the here and now. Dance-hall music—today's reggae—blasts across Jamaica. Its lyrics are often direct exhortations to kill gay people, or others who displease the island's gangs. Jamaica Labour Party supporters tauntingly played “Chi Chi Man”, a song about killing and setting fire to gay men, at their rallies during the general election two years ago.

Unlike AIDS in the rest of the Americas, AIDS in the Caribbean is not mainly a gay disease. In Jamaica, where 1.6% of adults are HIV-positive, two-thirds became so through heterosexual contact, says the health ministry. But homophobia helps spread infection. Terrified of stigma, those at risk—gay or otherwise—may shun health-care advice, let alone testing. For some women, suggesting that a man should use a condom can invite trouble. And buying water-based lubricant, which cuts the risk of condoms tearing, is too scary for some—though Jamaica plans to start issuing condoms and lubricant free of charge. Some health workers are exemplary, others are said to be atrocious—degrading patients, breaking confidences or denying treatment altogether—though all this is also said to be getting better.

With British support, 18 Caribbean health and labour ministers and a bevy of HIV/AIDS professionals met in St Kitts this week to find ways of removing the stigma. Britain's junior international-development minister, Gareth Thomas, was up-front about “reggae and rap songs actively encouraging discrimination against those who have AIDS and encouraging violence”. There is now a vague commitment to training “champions for change”, carrying out more advocacy and monitoring, and reviewing existing legislation.

One of the toughest nuts to crack is the spread of the disease in prisons. In many Caribbean countries, around 1% of the adult male population is serving time. Sex—forced or with consent—is common. Infection spreads not just in jail, but also to wives and girlfriends after prisoners are released. Prisons hold a captive audience who are sometimes given health education. Providing condoms would not require much money. But prison officials blench at the thought of free condoms, despite a legal duty on most islands to “prevent contagion”. In 1997, Jamaica's prison authorities floated the idea of distributing condoms in jail. Their staff walked off the job in protest at the suggestion that some were having sex with prisoners. In the riots that followed, 16 prisoners were killed.

A few politicians argue for reform. Delroy Chuck, the Labour Party's justice spokesman, says that the law

has no place in private morality. His, however, is a lonely voice. The director of the national HIV/AIDS programme, Yitades Gebre, in a letter to Human Rights Watch, called its report “distorted” and “inflammatory”. The tourism minister, Aloun Ndombet Assamba, publicly demanded, “bring me the proof.” The report is based on detailed interviews with some 130 people, including victims of violence, former convicts, health workers and local and foreign officials. That is about as much proof as an NGO can provide.

So who can investigate complaints about the police or health-service personnel, and take action if necessary? For the police at least, Jamaica has a Public Complaints Authority. It is chaired by Lloyd Ellis, a former judge. The Human Rights Watch report quotes him as saying that he would be surprised if anyone could prove police abuse of homosexuals, but “if that is done, it is done not by police acting *qua* police, but as citizens.” And if citizens were beating gays up, they were “doing it out of necessity.” So that's all right, then.

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Myanmar

Deep freeze

Nov 25th 2004 | YANGON
From The Economist print edition

AP

Reform, and indeed most of government, now seems to be paralysed

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SOE WIN, Myanmar's new prime minister, has undergone quite a career change. Until last month, he was a lifelong soldier and the third-ranking member of Myanmar's military junta, the State Peace and Development Council. Many democracy activists, along with the government of America, accused him of masterminding a bloody ambush last year on the motorcade of Aung San Suu Kyi, Myanmar's most famous dissident and winner of the Nobel peace prize. Now he must talk up the very process he was allegedly trying to derail: Myanmar's long-awaited transition to democracy. At the annual summit of the Association of South-East Asian Nations (ASEAN), which opens in Laos on November 29th, he will brief his counterparts on Myanmar's progress.

There will be little to say. Miss Suu Kyi has been under house arrest since last May—the most recent of several prolonged spells in detention. The regime has shut all but one office of her party, the National League for Democracy (NLD). In theory, it is still implementing a seven-point “road map” to put an end to 42 years of military rule. But the first step on the road, the drafting of a new constitution, has been entrusted to a convention stacked with government stooges, which the NLD is boycotting. The convention is due to reconvene in February, to rubber-stamp a draft constitution which would, among other things, reserve a quarter of seats in parliament for the army and bar Miss Suu Kyi from high office. Ultimately, many observers believe, the army hopes to legitimate its rule by rigging a notionally democratic system in favour of its supporters, a tactic it first tried in 1990, only to have its plans backfire when the NLD swept the board.

The biggest change since the previous ASEAN summit is the sacking of General Khin Nyunt, the former prime minister and cheerleader-in-chief for the road map. On the face of things, his arrest last month should make little difference. The junta is strenuously insisting that its policies have not changed, even if its personnel has. Than Shwe, the top general, will continue to make all important decisions. Anyway, Mr Khin Nyunt was just as implausible a democrat as Mr Soe Win. For almost 20 years, he headed military intelligence, the agency responsible for repressing dissent.

But Mr Khin Nyunt's removal has caused great disruption, as the junta attempts to purge the government

of his allies. A supreme-court justice was the latest to go, last week. Many of the myriad functions of his intelligence empire, such as media censorship and control of immigration, are being assigned to other agencies. Businessmen and diplomats complain that no one in the government dares take responsibility for any decisions in the midst of this reshuffle.

The government is also unravelling Mr Khin Nyunt's business empire. It has shut down a travel agency owned by military intelligence and is trying to sell off the spooks' stakes in various hotels. It also appears to have taken over Bagan Cybertech, Myanmar's main internet service provider, which was run by Mr Khin Nyunt's son. It is even impounding the unlicensed cars that Mr Khin Nyunt's subordinates smuggled into the country through border checkpoints under their control. Mr Khin Nyunt and his intelligence colleagues, it seems, had gone even further than the rest of the top brass in exploiting their positions for financial gain—one of the reasons for his downfall, perhaps. The junta has accused them of amassing 3 billion kyat ($3.1m), 42 tonnes of jade and 1,300 pearls in just three months at one border crossing alone. Divvying up such spoils will doubtless preoccupy the other generals for some time to come.

Another of Mr Khin Nyunt's responsibilities was to handle relations with the 17 former insurgent groups with which he had previously brokered informal ceasefires. These guerrillas, from ethnic minorities for the most part, are now worried that Mr Khin Nyunt's demise will impinge on their ill-defined autonomy. Rumours are circulating in Yangon that the junta wants to sign written agreements which would require the ethnic militias to stop recruiting and training, for example. A delegation from the Karen National Union, an insurgent outfit which was negotiating a ceasefire with Mr Khin Nyunt in Yangon at the time of his arrest, had to give up and go home, since following his fall the government was apparently unable to find anyone else suitable to speak to them on its behalf.

As if to prove that Mr Khin Nyunt was not the only person who could get anything done in Myanmar, the government did recently announce that it was releasing 4,000 prisoners, including 30 of the country's 1,300-odd political ones. The most famous of them, nicknamed Min Ko Naing, or “Conqueror of Kings”, has been jailed since 1989 for leading peaceful demonstrations against military rule.

ASEAN might seize on this gesture as proof that the regime is still moving in the right direction without Mr Khin Nyunt. After all, the club's members have long declined to interfere in one another's internal affairs. The summit is taking place in communist Laos, where dissidents also vanish.

But ASEAN's more progressive members are increasingly uneasy about being represented by Myanmar, which is due to take over the group's presidency in 2006. Malaysia, for one, has argued that ASEAN's credibility rests on persuading Myanmar to take more substantial steps toward democracy. Indonesia, which recently underwent a successful transition from authoritarian rule to democracy, could also act as a voice of reason. And Thaksin Shinawatra, Thailand's prime minister, who feted Mr Khin Nyunt as a man the world could do business with, now has egg on his face. Myanmar's military rulers, by contrast, seem to be entirely impervious to embarrassment.

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Human rights in North Korea

Much abused

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More evidence, but little action

Get article background

IS THE world's most secretive regime preparing to loosen up or crack up? Street markets in Pyongyang may be a sign of genuine attempts at economic reform, yet the flow of refugees reaching South Korea, via foreign missions in China and now Russia or by way of the dangerous underground routes through China to Mongolia or South-East Asia, steadily increases. Numbers are up from a handful a year in the early 1990s to almost 1,300 last year and still more this year. Some North Korea-watchers predict that political collapse could come suddenly and soon. But the regime of Kim Jong Il still maintains an iron grip that gives North Korea arguably one of the worst human-rights records ever.

With the refugees, and those preferring to cross back and forth over the northern border into China to find food or work, come tales of protest leaflets in towns and disaffection among even senior communist-party and army officials. Meanwhile, would-be escapees rounded up by the Chinese authorities are returned (there are estimated to be up to 200,000 North Koreans on China's side of the border at any one time) to face imprisonment, torture and, in the case of pregnant women, forced abortions. Those thought to have had contact with churches or missionaries working under cover to provide food and shelter are treated particularly harshly.

As refugee numbers have swelled, evidence has accumulated, backed by satellite photographs, of the network of prison camps, estimated to hold some 150,000-200,000 political prisoners and their families (guilt by association in North Korea can mean incarceration of up to three generations). Earlier this year a BBC documentary reported evidence of experiments on some of these prisoners to test chemical or biological agents. Other such reports have since emerged; indeed, such stories are almost commonplace when refugees are interviewed, say South Korean human-rights workers. These and other reports of the use of prisoners for slave labour have led to increased international pressure on North Korea over the abuses.

This year the UN's human-rights commission appointed a special rapporteur for North Korea, although he has yet to be allowed in to investigate. Recent legislation in America calls for the appointment of a State Department special envoy, provides extra cash to help North Koreans abroad and to break the regime's monopoly on information at home, and makes it easier for those who do escape (though not those already in South Korea) to win asylum in the United States.

Yet South Korea's government has been heavily criticised by opponents for what is called its “silent diplomacy”—refusing to speak out publicly, not only about the mistreatment of North Korean political prisoners and escapees, but also about the almost 500 South Korean citizens believed to have been abducted over the years by North Korean agents. Japan, by contrast, made concerns over its abductees central to its talks with North Korea; and China has quietly agreed to send any North Koreans of Japanese origin that it finds to Japan, not North Korea. South Korea is worried that publicity over human-rights abuses and the plight of refugees—as when 468 North Koreans were flown from Vietnam to South Korea in July—only causes China and those keen to keep on good terms with the North to take harsher measures to stem the flow.

But China, too, is being leaned on by America, among others, to stop tossing back all North Koreans it picks up as mere “economic migrants”. China is party both to the 1951 UN convention on refugees and a 1967 protocol, which ought to give better protection to fleeing North Koreans. But it refuses to allow the UN any access to the refugees, who it claims are law-breakers. With a friend like China, North Korea's regime will go on mistreating its hapless citizens and expect to get away with it.

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Japan

Lotus politics

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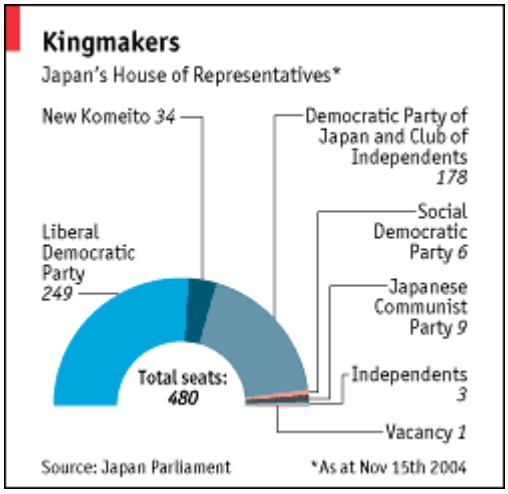
Could Japan's Buddhist-backed third party switch sides?



IT IS easy to see why Junichiro Koizumi gets on well with George Bush. The prime minister wants to expand the role of Japan's armed forces, which have helped America in Afghanistan and Iraq. His Liberal Democratic Party (LDP), like Mr Bush's Republican party, relies on rural backing and is loathed by many urban voters. And each man owes his power partly to a large, loyal and committed group of religious voters. Yet whereas Mr Bush gets on famously with America's evangelical Christians, Mr Koizumi seems an odd bedfellow for the peace-loving lay Buddhists who back his ruling coalition.

Formally, the LDP's coalition partner, New Komeito, which has 34 lower-house seats in parliament, is separate from Soka Gakkai, a lay Buddhist organisation with more than 10m Japanese members. Soka Gakkai makes no campaign donations to New Komeito, for example. Yet a Soka Gakkai spokesperson concedes that it is New Komeito's “main supporting organisation”. And that support clearly helps New Komeito and its coalition partner to win elections, especially in urban areas where the LDP is relatively weak.

Many Japanese attest to the eagerness with which Soka Gakkai members chase them down during election season to bend their ears about New Komeito and its place in government. And ruling-coalition MPs, whether LDP or New Komeito, show deference to Soka Gakkai, convinced that its members help them on polling day.

Such support has become even more important in the past year, as Japan's once fractious political system has coalesced around the LDP and its opponent, the Democratic Party of Japan (DPJ), leaving New Komeito as the only other party of note. Lower-house elections a year ago decimated the Social Democrats and Communists on the left, and drove the New Conservatives to extinction on the right. Upper-house polls this summer continued the trend, and raised the odds that the DPJ might match or surpass the LDP in the next general election. If it has a chance to put the DPJ in power, will New Komeito—which already holds the balance of power in the upper house—switch sides?

Defence policy is an obvious area to watch. But New Komeito might not achieve much by changing sides. Many DPJ members, like Mr Koizumi, want to bolster Japan's Self-Defence Forces, and either revise the pacifist constitution or re-interpret it less restrictively.

Nor do the LDP and DPJ differ much in other ways. Either party would have to make painful changes to health-care finances and pensions. “For now,” says Hirotsugu Terasaki, a Soka Gakkai vice-president, “we accept that the LDP is the party best able to govern Japan, and see Komeito's presence in the coalition as an important brake on the LDP's rightist tendencies.” The LDP had better be careful, however. If it lurches too far rightwards, the political karma could be swift.

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Pakistan

Signs of a truce

Nov 25th 2004 | LAHORE
From The Economist print edition

General Musharraf needs new friends

Get article background

WHAT lies behind the sudden release from prison this week of Asif Zardari, the husband of Pakistan's former prime minister, Benazir Bhutto? Mr Zardari has spent the past eight years in prison, though he was never convicted in any of the 16 cases of murder and corruption lodged against him. The Supreme Court's decision to free him simply “demonstrates the independence of our judiciary”, according to Shaukat Aziz, the third prime minister selected by President Pervez Musharraf in the last two years to do his bidding.

Cynicism, though, is in order. Mr Zardari's freedom came after a statement four weeks ago by Mushahid Husain, the secretary-general of the ruling Pakistan Muslim League, calling for a political reconciliation, and suggesting that the release of Mr Zardari might be a good place to start. Since then, the rumour-mill had been busy with talk of a rapprochement between Mr Musharraf and Miss Bhutto, leader of the People's Party, Pakistan's largest, who also faces corruption cases and has herself been in exile since 1999.

For the fact is that the general is in a hole. He wants to stay on as both army chief and president, despite a pledge last year to doff his uniform. But both the mullahs of the Muttahida Majlis-i-Amal (MMA), a powerful group of religious parties who were previously his allies, and the liberally-inclined People's Party are threatening to boycott parliament and make General Musharraf's system of “guided democracy” unworkable. Worse, all the opposition parties are ready to take to the streets.

General Musharraf can ill afford to see his government destabilised just now. The economy has just started to pick up after being crippled for years by rumours of war with India. The war against terrorism is yielding dividends. And the Commonwealth has readmitted Pakistan to its fold. All this could be put at risk by a political show-down. It is also no secret that America would much prefer the general to make up with the pro-western mainstream parties, especially Miss Bhutto's, and abandon his working relationship with the anti-western and anti-India mullahs of the MMA. All of which brings us back to Mr Zardari, and the intriguing possibility that Miss Bhutto herself may be on her way back to join him early next year.

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India and Pakistan

No shortcut to peace

Nov 25th 2004 | DELHI
From The Economist print edition

The peace process has slowed to a crawl again. India is glad

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EPA

Singh (right) won't budge for Aziz

FOR a few hours earlier this month, the flying visit by Shaukat Aziz, Pakistan's prime minister, to Delhi on November 23rd and 24th, looked as if it might be an “historic moment”. So it seemed to Umar Farooq, a leading Muslim cleric and separatist leader in Indian-controlled Kashmir. The visit was, in fact, a damp squib. This was a relief to those in Pakistan who thought Mr Aziz was about to abandon the country's 57-year-old stand on Kashmir. Curiously, India was no less relieved.

What had prompted Mr Farooq's sense of history was the suggestion that Mr Aziz might come to Delhi with a formal proposal on Kashmir, which India had said it would consider. His president, General Pervez Musharraf, had last month “thought out loud” (and into a microphone) about possible solutions to the dispute. His thoughts were deniably vague, but seemed to refer to a plan first mooted in 1950 by Owen Dixon, an Australian judge. Always unacceptable to India, this would nevertheless constitute a huge Pakistani concession—the dropping of its demand for a United Nations-sponsored plebiscite in Kashmir on its future.

However, Manmohan Singh, India's prime minister, despite having criticised Pakistan for negotiating through the press, then did just that. He said India could not countenance any redrawing of the border, or further division of the country on religious lines. General Musharraf fumed: he is under great political pressure (see article) and needs evidence that the peace process is not a sell-out. So Pakistan reverted, like India, to what the general called its “maximalist” position, the plebiscite demand. The general's musing on Kashmir was dismissed as intended merely to spark an internal Pakistani debate. The “historic moment” had passed before it arrived. Mr Aziz's visit became an exercise not in making breakthroughs, but in mending fences.

This it did. Mr Aziz and Mr Singh, both technocrats who made their names as successful reformist finance ministers, had plenty else to talk about. Both sides are excited about the prospect of a gas pipeline from Iran to India across Pakistan. They also hope that it may be possible, in talks next month, to reach a compromise on the travel documents passengers would need if a bus route were opened between Indian- and Pakistani-controlled Kashmir. Pakistan worries that if travellers did need passports, it would concede forever that the “line of control” which divides Kashmir is a permanent international border.

So, all in all, India had its way. It has always wanted the peace process, formally launched only in February, to move slowly through a whole range of confidence-building measures before tackling Kashmir. Pakistan is more impatient, needing progress on Kashmir, the core of the dispute, to prove it is not simply being strung along. India has just taught it that attempts to force the pace will backfire.

This approach, however, makes it harder for Pakistan to abandon entrenched diplomatic positions, and further weakens Mr Musharraf at home. It also continues to leave Kashmiri separatists out in the cold. Mr Aziz met some of their leaders. One, Yasin Malik, warned him that Kashmiris have a right to a seat at the peace table, and, if they are denied one, will have no option but to start “non-violent agitation” both in Indian Kashmir and in Pakistan's part. That would look even worse for Mr Musharraf.

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India

Bhopal's deadly legacy

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From The Economist print edition

The suffering and the lawsuits continue

TWENTY years after lethal gases from a Union Carbide pesticide factory billowed across a densely populated shanty town in the Indian city of Bhopal, both the dilapidated plant and its highly contaminated surrounding areas stand as monuments to governmental and corporate inaction. Compensation has still not been fully paid to over 500,000 victims, the plant has not been dismantled and toxic waste estimated to amount to several thousand tonnes remains on the site, polluting local water supplies. Legal cases are continuing in both Bhopal and New York against the American company, which was taken over by Dow Chemical in 2001, and against Warren Anderson, Union Carbide's chairman in the early 1980s, whom India has tried and failed to extradite and whose effigy will be burned in Bhopal at ceremonies to mark the anniversary.

The accident happened on the night of December 2nd 1984 when water accidentally entered a methyl isocyanate (MIC) storage tank, triggering an uncontrollable chemical reaction and blasting a cloud of toxic gases across nearby slums. Bhopal's poor died coughing and choking, while the gases burned into the survivors' eyes and lungs, to cause permanent ill health or early death. According to official figures, up to 3,000 people were immediately killed, and the death total now stands at over 15,000. Independent estimates put the initial death toll as high as 8,000, partly based on the number of shrouds ordered for wrapping the dead, and the final figure at over 30,000. Another 570,000 people have qualified for compensation because of health disorders.

The surviving victims' immune systems have been weakened, leading to chronic respiratory disorders and a susceptibility to diabetes. There are complaints of chest pains, stiffening of limbs, brain damage and psychiatric problems. Independent reports say that some boys born to gas patients have small skulls and are stunted, while girls have menstrual problems. The site and an adjacent chemical-dump area, which are owned by the state government, are highly contaminated, as are local water supplies. Independent inspectors organised by Greenpeace, an environmental organisation, reported on November 4th that there were 25,000 tonnes of contaminated material at the site. But the state government in Madhya Pradesh, of which Bhopal is the capital, has done little—apart from smartening up the perimeter with a grey and pink wall—ahead of the current anniversary.

Dow Chemical, together with its Union Carbide subsidiary, denies responsibility for victims' health or the state of the site, following an overall settlement reached in 1989 with the Indian government. The claims totalled $3 billion, but the government settled for $470m (then worth 7.5 billion rupees) plus a further $43m in rupees. A criminal case is in progress in Bhopal, and a New York court has yet to decide whether the company should be ordered to clean the site, in addition to paying out more for health problems. Payment of the $470m compensation to victims and those suffering ill health has been slow, mired in bureaucratic delays, judicial appeals and corruption. Eventually, by late last year, most of the 570,000 confirmed victims had received payments averaging 25,000 rupees. That left 15.6 billion rupees (at current dollar values), which is being distributed on orders issued last month by India's Supreme Court.

Politicians and activists' organisations now seem to be thriving on the aftermath of the disaster. Uma Bharti, a prominent Bharatiya Janata Party politician who was briefly the state's chief minister, promised in her election campaign earlier this year to try to spread the payment of compensation across Bhopal's entire 1.6m population. The current chief minister, Babulal Gaur, has refused to recognise the water

contamination problems even though, as a young lawyer in 1981, he won compensation for farmers whose cattle had died after drinking from solar evaporation ponds built by Union Carbide to dispose of toxic waste.

“After the twin towers attack on 9/11 in New York, America meted out punishment within a few months, compensation was begun within a year along with site cleaning and a memorial—but none of that has been achieved here,” says Abdul Jabbar, a local activist. He and others want the chemical plant to remain, a blot on the landscape, “so that people remember, as they do at Hiroshima”.

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Sudan

The worst is yet to come

Nov 25th 2004 | NYALA
From The Economist print edition

EPA

Even if the fighting in Darfur ends soon, which it won't, the number of starving people could double

TRYING to explain the causes of his country's civil wars, John Garang, the southern Sudanese rebel leader, told the UN Security Council last week that there had been a “failure to manage diversity”. That is one way of putting it. Another would be to say that the Arab-dominated government in Khartoum has orchestrated mass murder and rape among any ethnic group it suspects of supporting any of the country's rebel movements.

Such tactics have led to the death of perhaps 2m people in the long-running war between the government and the mostly-Christian and animist south of the country, and another 70,000 or so in the newer war in the all-Muslim western region of Darfur. The good news is that the north-south war is winding down: the government and Mr Garang's rebels signed a memorandum on November 19th committing both sides to a final peace deal by December 31st. The bad news is that the worst is still to come in Darfur.

Stroll through the streets of Nyala in south Darfur and you would not guess it. Elegant women swish through the bustling market and traders sit surrounded by plump sacks of produce. There are fewer armed men around than in many an African town at peace.

All this, however, is a cruel illusion. The army and their murderous government-sponsored allies, the irregular *janjaweed* militia, have driven some 1.5m people—nearly a quarter of Darfur's population—from their homes. Most now live in miserable camps. The World Food Programme (WFP) fed 1.3m of them in September, but fresh fighting and banditry meant it could reach only 1.1m last month. Perhaps another 400,000 hungry Darfuris are trapped in areas that the UN cannot get to.

Even worse, a new survey has found that, because of the conflict, only half as much land has been cultivated in Darfur as in a normal year. Many farmers, even if they are still in their villages, dare not visit their fields for fear of the *janjaweed*. The rains have been sparse and erratic, too. Darfur is facing a disastrous crop failure.

Next year, the WFP guesses it will have to feed not only 1.45m refugees but also an equal number of Darfuris starving at home—some 2.8m in all. Even if the war stopped today and everyone went home, it would be a whole year until the next harvest. Even in villages not threatened by the fighting, many people are leaving home and heading for the refugee camps, where they at least hope to be fed.

Roughly speaking, the war in Darfur pits sedentary black African farmers against nomadic Arab tribesmen, who live off their vast herds of camels. In areas from which the farmers have been driven, the UN reports that the nomads' camels and cows have been eating and destroying what was left in the fields.

And it is not only the Africans who face disaster. This is the time of year when the nomadic Arabs traditionally migrate northwards to the lands where their camels breed. But now their way is blocked by the rebels who occupy much of central Darfur. No one knows for sure, but one UN official estimates that 100,000 camels, cows and their herders are trapped in pockets near the towns of Kutum and Kabkabiyah. The animals cannot be exported, as they would usually be, and nor will they breed. Their Arab owners now lack the cash to buy food—not that there is much food to buy in rural Darfur.

Yet another ceasefire between the government and Darfuri rebels was signed on November 10th, but it was swiftly broken by both sides. This week, the rebels captured, and were then driven out of, the town of Tawila in North Darfur. Save the Children, a British charity, said it was forced to pull out of the town after government planes dropped bombs a few yards from one of its feeding centres. The government denied bombing anyone, as usual.

The longer the conflict goes on, the worse it will get. Black Darfuri refugees know that the government armed the Arab nomads whose camels are now grazing in their fields. They fear that its eventual aim is to strip them of their land and force them to become the Arabs' serfs. A law passed in 1982 gives squatters' rights to land if the original owners have not been present for a year.

In July and September, the UN Security Council threatened unspecified sanctions on the Sudanese government if it failed to disarm its genocidal militias in Darfur. The government did nothing of the sort, but no sanctions followed. Last week, the Security Council issued a new, milder threat, to “take appropriate action against any party failing to fulfil its commitments.” Carlos Veloso of the WFP, asked if the forecast of 2.8m starving Darfuris next year was a worst-case scenario, said: “No, that is the medium-case scenario.”

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Zimbabwe

Where have all the people gone?

Nov 25th 2004 | BULAWAYO
From The Economist print edition

Perhaps a quarter of the Zimbabwean population has gone missing

Get article background

EPA

Get me out of here

TWO or three million Zimbabweans are missing. Out of a population of less than 12m, that seems rather a lot. For various reasons, President Robert Mugabe's regime refuses to publish the results of a national census carried out in 2002, but *The Economist* has obtained a detailed summary. If the population had continued to grow as expected after the last census, in 1992, there would have been about 14m people in the country. But there were only 11.6m. What happened to the rest?

Some have died of AIDS, which has slashed the average life expectancy from 61 years in 1990 to 34. The disease also makes women less fertile, thus reducing the birth rate, which is further depressed, at least in the cities, by chronic food shortages. “I'd love to have more children,” says a father of one, “But how would I feed them?”

Probably the biggest factor, however, is emigration. Since Mr Mugabe started grabbing white farms—farming is Zimbabwe's largest industry—and giving them to his supporters, the economy has collapsed. Between 1999 and last year, it shrank by more than two-fifths, and it is expected to plunge another 8% this year. With no jobs at home, young men, especially, are trying their luck in South Africa. Its government says that as many as 3m Zimbabweans now live there, though this is a guess.

Southern Zimbabwe, meanwhile, is ghostly quiet. Your correspondent sped along empty roads last week: few drivers, except the police, can afford or find fuel. Some hospitals are said to be using donkey carts in place of ambulances. The restaurants, lodges and shops that remain open are mostly empty. Roadside stalls once crowded with stone sculptures for tourists lie abandoned. David Coltart, an opposition MP in Bulawayo, Zimbabwe's second city, says his legal practice is one-third of its old size; most partners have emigrated.

Women now far outnumber men in Zimbabwe, and the very young and very old outnumber adults of working age. In a typical household in Pumula South, a township of Bulawayo, ten children gobble maize paste from plastic plates under a hot tin roof. Their various parents have been “out” for several months, says their grandmother.

That is, they are in Johannesburg, flipping steaks or working illegally in shops. Sometimes they send back a bag of flour with a few folded banknotes hidden inside. But only sometimes. In other townships, the story is the same. “Almost all my friends are in South Africa and my relatives are in Britain,” says a man in Nkulumane, also on the edge of Bulawayo.

The brain and brawn drain has thrown Zimbabwe's once-excellent public services into disarray. Teachers face classes of over 80 children. Clinics are nurseless. The rubbish in Bulawayo is rarely collected, grumble residents. “If you throw a stone now, you hit a rat,” says one. It takes three months' salary to buy a bicycle. Pensions are nearly worthless, at about $2 a month.

Even the lucky few who got free land under Mr Mugabe's land-reform programme are disgruntled, as even fewer can afford the means to farm. A used tractor, which cost Z$800,000 two years ago, now sells

for Z$70m. Farmers who somehow manage to grow food find it hard to sell, because the government maintains a rigid monopoly on the distribution of grain, to make sure its own supporters are fed and dissidents are not. Anyone caught moving more than a couple of bags of maize is liable to be arrested.

Will anything change? The economic slump cannot last for ever. Investment in platinum mining may even spur a little growth next year. But without a legitimate government, serious trade and aid will not resume, nor will exiles return. A general election is due in March, but it is sure to be rigged, like the past two national polls.

It is a fair bet that most of those millions of émigrés would like to oust the ruling party, but Mr Mugabe has made sure that they will not be allowed to vote. The opposition is barred from all broadcast media; most independent papers have been shut. Secret police terrify peasants into not talking politics and threaten to break up public gatherings of more than five people. A proposed electoral commission will be under Mr Mugabe's thumb.

The main opposition party, the Movement for Democratic Change, may not even contest the election. “What can the MDC bring?” asks a man in Nkulumane. “Most of its members are gone, arrested, dead, or they are in South Africa. There is no hope.” He then begs not to be named, for fear the police would come knocking on his door.

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Iraq

The sour Sunni heartland

Nov 25th 2004 | MOSUL
From The Economist print edition

The prospects for getting Sunni Arabs to vote look bleak

Reuters

We'd rather you didn't vote

THE people of Arij, a dirt-poor Sunni Arab village half an hour's drive south of Mosul, Iraq's biggest northern city, have only dimly heard about the general election, now due on January 30th. Unlike families in Baghdad, the capital, they have not received voter-registration notices with their monthly food ration. Nor are they aware of any political parties active in their area—except, of course, the underground remnants of Saddam Hussein's Baath Party; nor do they even admit to caring. They claim that under Mr Hussein they were ignored, but their links to the new regime's authorities are no better. No one has come to fix their muddy water supply or to offer them jobs as guards in the nearby cement factory. The election prospect inspires them not a jot.

Even if they were keen to vote, it might be too dangerous, in this corner of the Sunni heartland, to cast their ballots. Two weeks ago, rebels launched an attack on Mosul, to divert the Americans' attention from the siege of Fallujah, from which the insurgents have now been bombed and chased out. The rebels are clearly hostile to the idea of voting: insurgents in Mosul burnt down a warehouse full of registration forms. Many Sunnis say that a free election under occupation is impossible. Some groups in the Mosul area, especially Salafi ones, say the very idea of a multi-party system is divisive and un-Islamic.

Mosul appears, on the surface, to be under the control of the Americans and their Iraqi allies again. But the mood is far worse than six months ago, when the city, with its mixed population of Sunni Arabs, Kurds, Turkomen and Assyrian Christians, was considered a haven of relative calm, despite the presence of many glum former senior Baathists and army officers.

The pro-government Iraqi forces plainly cannot handle the insurgents on their own. The Americans say that some units of the Iraqi National Guard, which is being trained to bolster the American-appointed interim government, stood and fought quite well when the insurgents attacked Mosul and the surrounding area. But a National Guard battalion based near Arij disintegrated, after its officers told the men on the eve of the attack not to bother to turn up for work the next day. Most of the Iraqi police in the area also deserted. Eventually, the Americans beat back the rebels, killing dozens of them. But they may well be nursing their wounds in preparation for another rising in Mosul, perhaps to coincide with the election.

In the election run-up, American forces are stepping up their hunt for guerrillas in the area around the city, combing through villages like Arij and seeking out local sheikhs and other leaders on whom to shower communal favours, such as water-purifying facilities and the renovation or building of schools, which the Americans reckon are key weapons in their counter-insurgency. For one thing, projects of this kind create jobs: poor villages such as Arij offer a pool of desperate men ready to make a few hundred dollars from well-funded Baathists and Islamists by launching rocket-propelled grenades at passing American convoys. For another, infrastructure projects enable officers on the spot to collect scraps of intelligence.

American largesse around Mosul in the first months after Mr Hussein's fall seemed to reap rewards. But the mood soured once it became clear that power was being transferred, in the summer, to an interim Iraqi government, which took longer to dish out the cash. Since then, the Sunni insurgents have

increased their threats against anyone who co-operates with the Americans or their Iraqi allies. There are signs of increased violence between Sunnis sympathetic to the insurgents and those who are contemplating electoral politics. The recent murder of several prominent Sunni clerics augurs worsening communal tension. American civil-affairs teams running infrastructure projects in the area say that many once friendly Iraqis have asked them not to stay in touch.

Even if Iraq's insurgents are kept at bay, few Sunni Arabs know who they would like to represent them, though a quarter of the 180-plus parties which have now registered have Sunni Arab bases. An Iraqi minister thinks that more Sunnis can be encouraged to come forward, perhaps by the holding of an open, multi-party conference before the election. “The ones we want to win over are the ones who have doubts, who aren't quite convinced [that elections will be fair],” he says. “We want to tell them to come and join the wagon.”

Perhaps, too, the violence in Iraq has peaked. The assault on Fallujah may not have hurt the wider insurgency but it proved a determination to win. That was underlined this week with the launch of another big American offensive south of Baghdad, an announcement that the Pentagon may send more troops, and an assurance by Iraq's tough minister for national security, Qasem Daoud, that his forces were ready to “repeat the Fallujah experience” in other rebellious towns.

Shia and Kurdish leaders are banking on a huge turnout in January, but the Sunnis' main parties wanting to join the electoral fray have been dithering and despairing. The best run of them, the Iraqi Islamic Party, wants the poll delayed by six months. Other ideas have been mooted to boost Sunni representation, for instance by reserving some of the 275 seats in the new assembly for Sunni leaders. Another proposal is to put prominent Sunnis on the constitution-drafting body that the future parliament will create.

It may be too late. Iraq's Shias, who make up about 60% of the population and have been itching for their chance to run the show for the first time since modern Iraq was created eight decades ago, are loth to wait any longer.

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Iraq

The neighbours say they'll help

Nov 25th 2004 | SHARM EL-SHEIKH
From The Economist print edition

The six countries bordering Iraq seem to want the rebels to stop fighting

AN ARAB newspaper called it a “conference of conspirators”. Iraq's Sunni insurgents denounced it as a “dirty and dubious farce”. In the event, this week's meeting at Sharm el-Sheikh, an Egyptian resort, of outside stakeholders in the future of Iraq was a sober exercise in realpolitik. The conference, which brought together Iraq's six neighbours, as well as the UN Security Council's permanent members, rich donor countries and key international bodies, showed that, despite lingering acrimony, the world at large concurs that the best way out of Iraq's bind is to help the Iraqis build a legitimate government. So they backed a plan to hold a general election, now scheduled for January 30th.

The participants converged on this conclusion from very different angles. The Americans and their western allies want elections not just because they think democracy is good or in the hope of spreading it in the region. They think the cleanest way to extract themselves is to lighten their burden of occupation.

Neighbouring Arab states are less keen on democracy. Yet, whatever their peoples' sympathy for Iraq's rebels, especially after the ruthless crushing of the insurgency in Fallujah, the growing religious and sectarian overtones of the violence are making them twitchy.

Arch-Sunni Saudi Arabia, for example, has been burned by jihadist “blowback” at home. Its rulers are no longer so fearful that an election could bring Iraq's 60% Shia majority to power and into a possible alliance with the kingdom's Shia rival, Iran. Besides, as Jordan's foreign minister, Hani Mulki, notes, Iraq's friends should back the interim government simply because “it's the only political group that can achieve something”.

Out of hostility to an equally hostile America, Syria and Iran have been especially reluctant to extend legitimacy to Iraq's American-sponsored political process. But Iraqi diplomats argue that if anyone wishes to speed the departure of American forces or to ensure that those in place will not be used against them, their best bet is to bolster an Iraqi government strong enough to influence the Americans' behaviour.

Yet Syria and Iran did agree with the others at Sharm el-Sheikh. As Iraqi diplomats ruefully note, those neighbours' enthusiasm might have been greater if America had been more willing to engage them with carrots as well as sticks. But they may anyway be less tempted to play the spoiler in Iraq. As much as hardliners in Tehran or Damascus enjoy seeing America bruised, the blinkered Sunni extremism that Iraq's jihadists increasingly display sits uncomfortably with both Iran's mullahs and Syria's Alawites, a heterodox minority to which the ruling Assad clan belongs. Anyway, the 20-month-long insurgency may well have made the Bush administration scrap any notion of reshaping Iraq as a pro-American bastion in the region.

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Ukraine's election

The two Victors

Nov 25th 2004 | KIEV
From The Economist print edition

AFP

The stealing of the Ukrainian presidency may yet be averted. But even if thieves prevail, the country has changed irrevocably

Get article background

AT FIRST, it felt like a democratic fairy-tale. On the night of November 21st, after the polls had closed in the second round of the presidential election, tens of thousands of euphoric Ukrainians gathered in Kiev's Independence Square to celebrate what the exit polls suggested would be a victory for Victor Yushchenko.

Swathed in orange, the colour of Mr Yushchenko's campaign, they were entertained by rock bands and addressed by elated Yushchenko allies as a gentle snow fell. The flag of Georgia, where another corrupt government was toppled a year ago, flew among the orange banners.

As it turned out, it was too good to be true—or rather, for Ukraine's current rulers, too bad to be admitted. The official election results purported to show a victory for Victor Yanukovich, the prime minister and the heir-anointed of Leonid Kuchma, the country's president since 1994. On November 24th, the central election commission eventually announced what it said was the final tally: a Yanukovich victory, by 49.5% of the vote to 46.6%.

By then, there was even more orange on the streets of Kiev than there had been on election night. Mr Yushchenko's supporters, it turned out, were as ready to defend their expected triumph as they were to celebrate it. A makeshift encampment, with tents and field kitchens, sprang up on Kiev's main thoroughfare; its occupants vowed to stay put until their man was declared president. Meanwhile perhaps hundreds of thousands of demonstrators rallied in the nearby square and outside the parliament and the presidential offices.

On November 23rd, Mr Yushchenko had gone to the Rada, or parliament, and symbolically sworn a presidential oath. Two days later Ukraine was stuck in a giddy, perilous impasse: the Supreme Court gave Mr Yushchenko a fillip by delaying publication of the “official” result.

Early and often

Mr Yushchenko is no street-fighting man: a cerebral liberal economist, he used to head the national bank and was briefly prime minister. Neither is he a natural politician. In a televised debate on November 15th—to which his less cerebral opponent had only reluctantly agreed—Mr Yushchenko reeled off numbers. That thousands of Ukrainians later spent days in the snow for him says more about distaste for the old rulers than about his charm.

The election has been characterised as a choice between east and west: between one candidate (Mr Yanukovich) who represents the industrial, Russian-speaking east of the country and would cuddle up to Moscow; and another who champions the Ukrainian-speaking west, and who would take Ukraine into NATO and apply for membership of the European Union. The endorsement of Mr Yanukovich by Russia's President Vladimir Putin before the election reinforced this perception.

Mr Putin—a former KGB officer and hammer of Russia's oligarchs—and Mr Yanukovich, an ally of some Ukrainian tycoons with a murky past of his own, make an odd couple. Indeed, as president, liberal Mr Yushchenko might prove more accommodating to Russian business interests than Mr Yanukovich. But for a mixture of geopolitical and atavistic reasons, Mr Putin embraced the current prime minister, and hailed his “victory”. Kiev's streets were rife with rumours that Russian troops were lurking nearby.

For most Ukrainians, the election had been, above all, about two domestic concerns. One was the poverty that continues to blight much of the country, despite the recent economic growth (for which both Victors claim credit). The other was the corruption that has permeated Mr Kuchma's presidency, and which Mr Yushchenko, who has an unusually clean history, made the theme of his campaign.

It worked. In the approach to the first round, the media coverage was skewed sharply in Mr Yanukovich's favour. Mr Yushchenko's rallies were disrupted. Up close, Mr Yushchenko's face still looks disfigured after what he calls an attempt to poison him. Manifold abuses took place on the first polling day. Yet, even by the official count, Mr Yushchenko prevailed in the first round, though falling short of the majority needed for outright victory.

Between the two votes, Mr Yushchenko picked up endorsements from several of the other candidates. And even Petro Poroshenko, one of Mr Yushchenko's top aides and the owner of a television channel that has been systematically harassed, admits that the media climate improved—partly because of a revolt by journalists at other channels, some of whom were sacked. So it was no surprise when second-round exit polls suggested a Yushchenko win by up to 11 points.

Every trick in the book

Corrupt governments, however, do not often go quietly. The falsifications on November 21st were egregious. Russian observers were sanguine about the poll, but European and American monitors were outraged. Among many brazen abuses, they noted the impossibly high turnout in some regions, and incredibly big victories for Mr Yanukovich; a dramatic rise, in some areas, of people voting at home; the expulsion of monitors from polling stations, as well as violent seizures of ballot boxes; and the abuse of absentee ballots, which state employees had been pressed to obtain and then give to their bosses, letting some Yanukovich backers vote several times. Just before the polls closed, *The Economist* saw about a dozen men trying to use such ballots in central Kiev. They became aggressive when questioned.

Perhaps only Mr Kuchma can now broker a fair and peaceful resolution. His associates present him as a global statesman emeritus; given his alleged involvement in political assassinations and illicit arms sales to Iraq, that may be optimistic. Still, it is just possible that nothing in his presidency will become him like the leaving of it: he might, for instance, work out a sort of compromise involving a recount or fresh elections, perhaps in concert with constitutional reform that would dilute the powers of the presidency. There have been rumours that some of Mr Kuchma's associates, who do not fully trust Mr Yanukovich, always intended such an outcome.

On November 24th, Mr Yushchenko said he might accept fresh elections. Failing that, will there be a revolution? Mr Yushchenko himself, who has in the past been criticised for his hesitancy, has become more bellicose. Both he and Yulia Timoshenko, his glamorous demagogic sidekick, have called for a general strike. There are parallels with what happened in Georgia—but also big differences. The government is better prepared for protests than was Edward Shevardnadze, Georgia's ousted leader. And much of eastern Ukraine really does back Mr Yanukovich.

Keenly enough, indeed, to fill the buses that streamed into Kiev from the east as this week progressed. Mr Yanukovich's backers established their own camp, and began to encounter the orange brigades on the capital's streets. Meanwhile, several city councils in western Ukraine, as well as Kiev's, have already refused to recognise Mr Yanukovich. East and west Ukraine have always been different; pessimists now foresee a rift, even a schism.

The likeliest outcome is still—on balance—that the Yanukovich camp sits tight, hoping the snow will eventually drive Mr Yushchenko's people inside (though so far their ranks have been swelling). If he does manage to steal the presidency through this rigged election, Mr Yanukovich will also inherit two big problems. The first is hostility both from the European Union and from America, which says it “cannot accept” the result officially claimed.

Senator Richard Lugar, President George Bush's special representative, has vigorously denounced both the elections and the government. Ukraine is too important for relations to be severed entirely, but Ukrainian power-brokers who value their status in the West are sweating.

More important perhaps, Mr Yanukovich would inherit a very different country from the one Mr Kuchma took over in 1994. The crowd in Kiev included students from Belarus, opposed to their country's tyranny. One voiced envy of the protests: we have nothing like this, he said. After this week, Ukraine can never go the way of cowed Belarus, or even of Russia. And it may even win its democracy, as Mr Lugar hopes, “now, not in the hereafter”.

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Ukraine's neighbours

A region transfixed

Nov 25th 2004 | RIGA
From The Economist print edition

Every central European eye is watching

Get article background

“THERE is a crisis in Ukraine—here in our neighbourhood,” Hungary's biggest-selling daily newspaper, *Nepszabadsag*, declared this week. It went on to ask: “Is Hungary prepared to accommodate people fleeing from Ukraine? What if Ukraine is torn in two? What if this leads to disruptions in energy supplies and gas shipments? Do Budapest officials have an emergency scenario for that case?”

AP

Nemtsov (left) needs Yushchenko

Poland was similarly gripped. Lech Walesa, a former president and a founder of Solidarity, said he was “ready to mediate a decent solution” if Ukraine's outgoing president, Leonid Kuchma, asked him. Either Ukraine should behave as a democratic country, Mr Walesa said, or “Russia will absorb it, as it has done with Belarus, and we will have the Soviet Union again, more dangerous this time.”

The crisis in Kiev dominated a summit on November 25th between the European Union and Russia. Poland, Hungary and Slovakia, EU members since May, all have borders with Ukraine, as does Romania, which hopes to join the EU in 2007. These central Europeans have a special fellow-feeling for countries struggling to escape Russian influence, as many of them did successfully 15 years ago. Belarus and Ukraine are two of the three countries currently “in play” between the EU and Russia. The third, Moldova, has elections due in February which promise to be confused. The ruling Communist Party is shifting from a pro-Russian to a pro-EU line, while parts of the anti-Communist opposition are fishing for support in Moscow.

Romania was keeping relatively quiet about events in Kiev this week, perhaps preoccupied with its own elections on November 28th, the conduct of which may not prove entirely beyond reproach. Hungary has a special object of concern: the 150,000 or so ethnic Hungarians living in western Ukraine.

These and other minorities abroad may be offered Hungarian passports, if a referendum in Hungary on December 5th forces a change in citizenship laws. Poland, which has declared itself a “spokesman for the integration of Ukraine with NATO and the EU”, and which has just taken over the presidency of the Council of Europe, was calling for a recount in Kiev.

In Polish eyes, a rigged win for Victor Yanukovich would be the worst of all worlds. Even if Mr Yanukovich turned out to be more pro-western than his rhetoric suggested, his tainted legitimacy would limit the EU's scope to respond. Poles know Ukraine as a divided, fragile country, with an eastern half with ties to Russia and a western bit that was once Polish.

They believe that only the long-term prospect of full EU membership will be enough to win Ukraine away from Russia, and to bring stability to the EU's eastern flank. The EU has so far refused to make such an offer. This week's turmoil in Kiev will supply fresh arguments on both sides.

Even in Russia, there are a few who see the Kiev stand-off morally, not strategically. Hard-pressed Muscovite reformers, like Boris Nemtsov, back the liberal cause in Ukraine; they will suffer if there is a broader East-West stand-off.

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Turkey

Not quite at ease

Nov 25th 2004 | ANKARA
From The Economist print edition

The secular soldiers have changed a lot—but they still watch carefully

Get article background

AFP

Ozkok gives the brass a different shine

WAS IT a warning from the generals? That's how it seemed to residents of Subayevleri, a middle-class Ankara neighbourhood, where the prime minister, Recep Tayyip Erdogan, and his family live, when a Turkish air force jet scraped off the tip of the minaret of a mosque near Mr Erdogan's home during practice for the October 29th Republic Day parade.

An unruffled Mr Erdogan retrieved a bit of the jet, presented it at a meeting of the National Security Council and demanded explanations. In the old days, the generals might have coolly acquiesced, yet done nothing. In fact, an apology was made, an inquiry launched and the minaret fixed. It does really seem to have been an accident.

The affair is a telling sign of recent changes in relations between the men in uniform and the country's civilian leaders—and of just how badly Turkey wants to join the European Union. Over the past year Turkey's government, led by reformed Islamists, has rammed through a series of reforms that are meant to persuade EU leaders to start entry talks next year. Besides scolding Turkey for repressing Kurds and torturing people, the EU has long chided the Turks for letting the generals (who have toppled four governments in as many decades) dictate policy.

The weak coalitions that used to rule the country—until Mr Erdogan came to power alone, two years ago—were afraid to confront the soldiers. Not so Mr Erdogan. In August last year, a parliament dominated by his Justice and Development party stripped the National Security Council (where generals used to bark orders) of executive powers and put it under civilian control.

From next year, parliament will be able to probe the armed forces' budget. This year, spending on education exceeded that on defence, another first. Perhaps more extraordinary than the changes themselves is that the men in uniform have accepted them. Much credit goes to Hilmi Ozkok, Turkey's top general, whose affability belies a sharp intellect and iron will.

Since becoming chief of the general staff in August 2002, General Ozkok has altered the face of the country's rigidly hierarchical and secretive armed forces. People close to the anglophile general, who spent nearly half of his career abroad, say he listens to subordinates. Unlike his predecessors, he realises that pressure will only stiffen the backs of politicians who lean towards Islamism; he prefers to co-opt them. He believes that the army should take its orders from the civilians (and has edged out a couple of generals who wouldn't) and wants Turkey to join the EU.

This is not just because he is a committed democrat. He knows that with over 70% of Turks in favour of the EU, the army cannot afford to stand in the way of membership without losing the popular respect it still commands. Besides, to do so would enable Mr Erdogan to supplant the armed forces in their traditional role as modernisers and pro-westerners. With the economy still recovering from a 2001 meltdown, the generals also sense that army intervention in any form could wreck the markets.

While most pundits agree that another coup is highly unlikely, they give warning that further pruning of the army's power is needed for Turkey to join the EU. The defence ministry is still subordinate to the

chief of the general staff, who reports directly to the prime minister. Moreover, under its own internal service regulations, the army is empowered still to “defend both the Turkish Fatherland and the Turkish Republic” from vaguely defined threats “ if necessary, by force”. Armagan Kuloglu, a retired air-force general, says his ex-colleagues won't easily relinquish this role.

Anyway, the men in uniform have not retreated altogether. Now they make their views known at monthly press briefings, where they speak out, albeit with restraint, against religious militancy and separatist violence. With the country's leftist opposition mired in feuding, some secular Turks welcome this dissenting voice. Others fear the generals may be sliding back into their old meddlesome ways. There is another worry: will General Yasar Buyukanit, the land forces commander poised to succeed General Ozkok in 2006, be as reasonable?

Much hinges on whether EU leaders agree, at their December summit, to launch entry talks. Ironically, in the likely event of a yes, some think Mr Erdogan will feel freer to assert his piety; and the army—once relieved of immediate pressure to behave itself—may turn up the volume of its critical noises.

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Italy

How to clip a prosecutor's wings

Nov 25th 2004 | ROME
From The Economist print edition

A so-called reform could limit the judiciary's freedom of action

Get article background

SOMETHING is awry when judges go on strike. Italy's have done so 14 times since the second world war, and thrice since Silvio Berlusconi, who is currently on trial for allegedly bribing judges, returned to power in 2001.

The latest one-day stoppage, this week, was called by the National Magistrates' Association (ANM), whose members account for about 90% of the country's judges and prosecutors. In Italy, both are classed as magistrates and belong to the same profession. Their strike capped a series of protests against a bill to reform the judicial system, as it went through its last stages in parliament. The ANM claimed that over 80% of magistrates stayed away from work. Coming for the third time in this parliament, protests lose their edge, and media interest dwindled—even though the magistrates' complaint goes to the heart of many people's fears over Italy's future under Mr Berlusconi.

Some objections to the bill are obscure, others obvious. Sensibly, it bans magistrates from belonging to political parties. And it makes them choose between becoming judges and prosecutors within five years of qualifying. That is designed to reduce the chances of collusion in trials between participants who should be entirely independent of each other. Defence lawyers also struck this week—in pursuit of an even sharper break between prosecutors and judges.

But prosecutors need to be protected as well as hived off. It is true that they are at times eccentric and high-handed. This month, one warned a reporter he was under investigation for “aiding and abetting” a string of killings after the newsman questioned his line of inquiry. The bill would make the promotion of prosecutors dependent on success in examinations and make them take psychological tests: fair enough. But the part of the bill that has caused outrage is its attack on the newly-segregated prosecutors' independence. In a place as corrupt as Italy, the need for strong, autonomous investigating magistrates exceeds the risk of occasional abuses.

The bill would concentrate responsibility for initiating criminal proceedings in the hands of chief prosecutors who, because of the job structure now created, may become more careerist and susceptible to political influence. It also extends the powers of the justice ministry both to shape the charges brought against defendants and to take disciplinary steps against prosecutors. Worries over this move grew in recent days after two lawyers prosecuting Mr Berlusconi were presented with new malpractice charges by the justice ministry.

Another concern is the future of the fight against organised crime. With their freedom curbed, can prosecutors really go after mobsters who may well have political protectors?

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German values

It's values, Dummkopf!

Nov 25th 2004 | BERLIN
From The Economist print edition

Weary of number-crunching wonks, Germans want to talk values instead

Get article background

AS EVERY lover of Bach or Beethoven knows, a *Leitmotiv* is a dominant theme in a piece of music. What, then, is *Leitkultur,* the new buzzword in German debates? Roughly, it means the guiding or dominant culture, or set of values, in a society. A growing number of Germans think their country needs one.

The very fact that people are discussing values more, including patriotism, is a big and recent change. For most of the past two years, politicians and pundits were talking technicalities; they sparred over arcane proposals to fix the economy. Since mid-November, however, there has been a palpable shift away from this dull techno-talk. Pragmatic approaches are being played down in favour of ethical ones.

Managers are criticised for lacking patriotism when they transfer jobs abroad; families and children are back in the headlines; even religion is staging something of a comeback. Germany's leading tabloid, *Bild*, for instance, has started selling a special edition of the Bible—and its editors got an audience with the pope to launch it.

Some symptoms of this shift are rather superficial. For example, Chancellor Gerhard Schröder has been showing more of his human side. In a recent talk show, he spoke of what it meant to him to have adopted a child from Russia. He has denounced his critics as unpatriotic, a new line of attack. His government is also working on a huge media campaign in the run-up to the 2006 soccer World Cup, which Germany will host. The object, aside from boosting Mr Schröder's election chances that year, is to improve the country's image abroad as well as the mood at home. Germans are being told to believe in themselves and the things they stand for, rather than fretting over fiscal drag and social-security payments.

Among the opposition Christian Democrats (CDU), too, there are signs that moral issues—including matters that might hitherto have been private—count more. In Baden-Württemberg, the contest between two CDU candidates to be the next state premier has turned very personal. One of them, Annette Schavan, issued an angry denial on November 23rd of rumours that she was a lesbian.

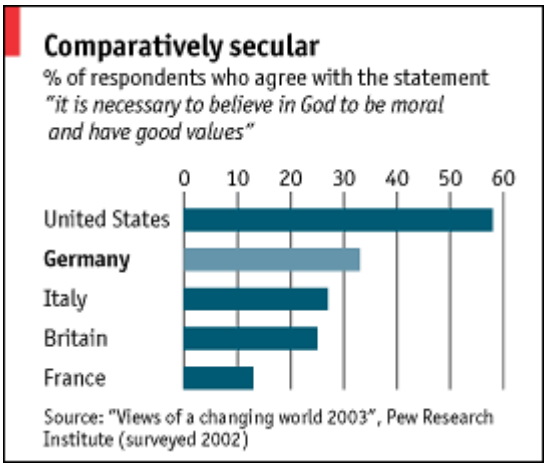
If values are in and economic technicalities out, some of the reasons are obvious. In America, George Bush has surprised Europeans by showing that it is possible to win elections by focusing more on moral issues and less on monetary ones. And in Germany, as everywhere in Europe (see Charlemagne), the challenge posed by immigration and political Islam is forcing people to think about the axioms a liberal democracy must uphold. There is much discussion about how immigrants should be helped to accept German *Leitkultur*.

Perhaps more than anyone else, it is Angela Merkel, the CDU leader, who has sensed, and driven forward, the public demand for the politics of values. For nearly a year, she toyed with modelling herself on Margaret Thatcher and her radical economic reforms. But in her most recent speech, she tried to underpin her reform plans with talk of ethics and the nation. At a party congress in December, she will offer a homily on “German interests”, shifting her focus to loftier matters than inflation and well-funded pensions.

One reason for the emphasis on ideals is prosaic: Germany's economic reforms, at least for now, have run their course. Mr Schröder has for some time thought Germans are tired of big structural changes and need a break. Ms Merkel's reform plans have also hit a roadblock. A quarrel about health-care reform between the CDU and its Bavarian sister party, the Christian Social Union (CSU), ended with an

incoherent fudge. This wrecked her plans for taking power with a big reformist bang and has forced her, and the CSU leaders, on to softer ground.

Politics aside, there may be something deeper at work. Germany has always boasted a peculiar mix of liberal and conservative values. Particularly since unification, it has—by American standards—been quite a secular country, though less so than other west European countries. Only a third of Germans deem it “necessary to believe in God to be moral” (see chart). Institutions such as family, marriage and the nation resonate less among younger Germans. At the same time, most Germans have looked to government to protect the environment and guarantee a social balance. However, this mix seems to be changing—and becoming more “American”. People are less inclined to see government as the solution to most problems, and traditional values and concepts are coming back, says Paul Nolte, the author of an influential book on the “metaphysics” of economic reform.



National identity is only one of the issues regaining salience, he adds. Having children is again considered important, though not necessarily in a traditional family; people are increasingly unhappy about egotism in society and irresponsible behaviour by the mass media; and even leftists now recognise the role of religion in society. Some of this reflects insecurity in an era of rapid change. But Warnfried Dettling, another pundit, sees a different reason. The government can no longer make much difference in big questions of foreign policy and the global economy. So people want it to focus on things nearer home, such as education and immigration.

It is still an open question whether Germany's politicians will simply use value-talk as a handy electoral tactic—or integrate it into their long-term strategy, and ultimately put new values into practice, says Matthias Machnig, a political consultant. Perhaps, as with many other things, a development that starts big in America will eventually, and in a more moderate form, happen in Germany too.

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Charlemagne

A civil war on terrorism

Nov 25th 2004
From The Economist print edition

How much of a threat does Islamic radicalism pose to western Europe?

GEERT WILDERS should be feeling good. This week the Dutch MP launched a new political party—demanding a halt to non-western immigration to the Netherlands for five years and a tougher line against Islamic radicalism. Some national opinion polls already put his party in second place. But Mr Wilders admits he is not sleeping well. His life has been threatened by the Islamic radicals he excoriates and it is no longer safe for him to live at home. Instead he moves between safe houses, and can travel only in an armoured car, surrounded by bodyguards. “It's like being trapped in a B-movie,” he says.

The Dutch security services are taking no chances because three weeks ago Theo Van Gogh, a prominent Dutch film-maker who had made a movie attacking Islam's attitude to women, was murdered on the streets of Amsterdam. And this was not any old street killing. Mr Van Gogh was dragged from his bike, shot six times and his head was nearly sliced off by an Islamic radical, who then impaled a five-page letter attacking the enemies of Islam on the chest of his dying victim. Ayaan Hirsi Ali, a Dutch politician of Somali Muslim origin who was repeatedly threatened in the letter, is also in hiding and, unlike Mr Wilders, has not re-appeared in parliament. Other prominent politicians and even some journalists now have permanent armed protection. “You're nobody as a columnist unless you have an armed guard,” jokes one eminent Amsterdamer.

The current atmosphere in the Netherlands will provoke some knowing nods on the other side of the Atlantic. For some months, leading American intellectuals have been pointing to what they see as the growing threat to western Europe from militant Islam. At a recent seminar at the Brookings Institution, Francis Fukuyama argued that “Europeans are threatened internally by radical Islam in a much more severe way than Americans are in terms of their external threat.” According to Mr Fukuyama, Europeans have hitherto been deterred from debating the threat by a “stifling political correctness”. But events like the Van Gogh murder are changing the debate. It is increasingly common for mainstream European politicians to call for much tougher measures against Islamic radicals and a more aggressive insistence on western liberal values. These demands have been heard with increasing force in all the west European states with significant Muslim populations—including France, Germany, Britain and Belgium—but above all in the Netherlands.

There is broad agreement that some limits to inflammatory speech must be defined—but where to set those limits and what to do with those who overstep them is still deeply controversial. Some Dutch politicians are arguing that Muslim sensitivities should be catered for by strengthening the blasphemy laws—Mr Van Gogh had outraged Muslims by broadcasting pictures of verses of the Koran scrawled on a naked female body and referring to Muslims as “goat-fuckers”. But others respond that a strengthened blasphemy law would go in the wrong direction. “There is no way you can appease Muslim radicalism,” says one academic, “If you go down that route, you will end up banning the sale of alcohol in supermarkets.”

Islam, Europe and demography

The debate on how to respond to Islamic radicalism has been made no easier by the confusion of several different arguments: about terrorism, about levels of immigration into Europe from the Islamic world and about the assimilation of immigrants. Some take an alarmist view of current demographic trends. Bernard Lewis, a British historian at Princeton University in America, said recently that by the end of the century “at the very latest”, the European continent would be “part of the Arabic west, the Maghreb”. This comment has been widely quoted—including by Mr Wilders in the Dutch parliament. But a glance at the figures suggests that Mr Lewis is a better Arabist than mathematician. At present there are not more

than 13m Muslims in the European Union, out of a total population of 457m. Even if there is a massive surge of immigration and the fertility of white Europeans falls even further, it is difficult to see how this will lead to a merger between Europe and North Africa.

The demographic picture in particular places is admittedly more dramatic. The Muslim population of France is now nearly 10% of the total. And it is officially projected that the three largest Dutch cities will have 50% non-western populations (most of them Muslim) by 2020. Yet even these figures need not be alarming, if Muslim populations assimilate easily. It is here that traditional liberal attitudes are undergoing a re-think. For Mohammed B, the murderer of Theo Van Gogh, was not a marginalised or oppressed figure. He spoke excellent Dutch and was studying for a diploma. It looks increasingly apparent that—as with the 9/11 hijackers—the problem is not lack of integration or opportunity, but a vicious ideology.

Depending on the numbers of people gripped by this ideology, that conclusion could be re-assuring or worrying. The Dutch secret service reckons there are only about 150 Islamic radicals on the fringes of terrorism in the country. This suggests the problem could ultimately be treated as a law-enforcement issue, as with the Baader-Meinhof gang that terrorised Germany in the 1970s. But Mr Wilders quotes Dutch academics who estimate that around 10-15% of the Dutch population of 1m Muslims sympathise with jihadist ideology. He says that the 150 suspected terrorists should be deported or imprisoned immediately. But he also demands a similar fate for those Dutch citizens who endorse jihadist ideology, whether in print, in a sermon or in an internet chat-room. Mainstream Dutch politicians still recoil from such measures, believing them to be incompatible with traditional freedoms—and likely to radicalise Dutch Muslims further. Launching a war on terrorism is one thing; a civil war on terrorism is altogether more daunting.

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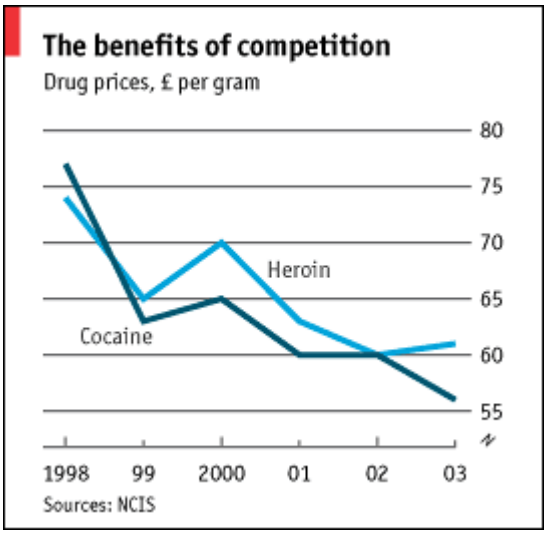
Drug trafficking

The price of powder

Nov 25th 2004
From The Economist print edition

The cheapness of illicit drugs isn't just a sign of police failure. It is also evidence that the drugs business has got more competitive



FOLLOWING a quiet spell, Britain's war on drugs seems to be heating up. This week, the Home Office unveiled legislation that will create a Serious Organised Crime Agency (SOCA), which, it is promised, will conduct "a specialist and relentless attack" on racketeers. Suspected traffickers will be compelled to produce documents and drug kingpins encouraged to inform on one another. Other legislation will force more addicts into treatment.

Hopes are high, which is surprising given the failure of previous efforts. Street prices of Class A drugs have fallen steadily in recent years (see chart) and the number of users has risen. Drug traffickers are running slicker businesses. "We dealt with a team a while ago that had a director of operations and a director of finance, and they actually called them that," says Bill Hughes, the appointed director-general of SOCA. More importantly, they are running a different kind of business.

The drugs trade used to be dominated by stable, vertically integrated outfits resembling mini-Mafia families. That was a response to the risks of doing business. Drug buyers may be undercover police officers; promises to pay may be broken (these are criminals, after all); trusted contacts may be jailed and rivals get shopped. Stable partnerships reduced these risks, as did recruitment from a shallow ethnic pool. But market forces have gradually pushed these cumbersome organisations out of business.

Competition in the cocaine trade has cut margins to minuscule levels, considering the risks involved. Powder cocaine from central America is sold in multiple-kilogram loads for £15,000-30,000 ($28,000-56,000). But the price for a single kilogram, £18,000-32,000, is barely higher, and the retail price not much more than that. Last year, the National Criminal Intelligence Service estimated that cocaine was selling for £56 per gram (equivalent to £56,000 per kilo) but the current London price is said to be around £40 per gram.

The falling price of powder is especially striking considering the supply problems of recent years. The United Nations Office of Drug Control (UNODC) estimates that global coca leaf production has fallen every year since 1999, from 353,000 to 236,000 tonnes. And, unlike heroin, cocaine is perishable, which means it cannot be stockpiled against lean times.

Margins are fatter in the heroin trade. Importers, many of them London-based Turks, sell multi-kilo loads to white British middlemen at £16,000-22,000 per kilo. The middlemen, who rarely deal in any other product, sell on to retailers at prices up to £33,000 for a single kilo, enhancing profits further by adulterating the drug. Heroin is then cut again before being sold on the street for the equivalent of £60,000 per kilo.

The reason why the cocaine price has fallen so much is that the market is opening up. Dave King, a drugs specialist at the National Crime Squad, says that the London-based Colombian importers who traditionally controlled the import and wholesale trades now contract freely with British entrepreneurs. A recent trend is for Britons living in Spain to deal directly with Central American suppliers before selling on to Colombians in London or directly to an army of middlemen.

New importation routes open frequently, sometimes as a result of police activity. Operation Airbridge, a co-operative Jamaican and British venture, proved so successful that traders have explored other routes through the Caribbean. Improvements in Spanish policing have encouraged traffickers to ship cocaine through Africa, where it can be bundled with other drugs likely to interest the same consumer. One of the biggest domestic seizures this year came from a warehouse in west London. Among a shipment of pineapples and vegetables from Ghana were ten kilos each of cocaine and marijuana.

By contrast, the heroin trade is more closed and less innovative. Mr King believes that is partly because demand for heroin is more inflexible than demand for other drugs. Reliability of supply is more important than price, which means there is less shopping around at any stage of the supply chain. Another barrier to greater competition is linguistic. To move cocaine from producer to market, English and Spanish are essential; to move Ecstasy, it helps to speak Dutch. But as many as 120 languages, from Italian to Pashto, are spoken by those involved in the heroin trade. That makes it tricky to seek out new sources or new routes.

Heroin traffickers do not constitute a cartel, though. They behave more like members of an oligopoly, with a mixture of competition and co-operation at the highest levels of the trade. Paul Evans, chief investigation officer at Customs and Excise, says that this can extend to emergency relief: “if your shipment hasn't arrived, someone else will loan you stuff to tide you over.”

Such cosy arrangements are likely to break down as new players enter. Turkish importers have already lost business to Kurds and Albanians—both groups now scattered across Europe, thanks to instability at home and higher immigration into rich countries. British-based Colombians squeezed out of the cocaine trade are dabbling in the more profitable opiates. The dissolving of ethnic and family bonds is likely to mean still freer trade.

Competition in the drug market is good for the consumer, which means it is bad for anyone trying to reduce or eliminate drug taking. Against Mafia-style cartels, the police might have succeeded. They are less likely to prevail against the invisible hand of the market.

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Migration

It's hot in the Highlands

Nov 25th 2004 | EDINBURGH
From The Economist print edition

Population and house prices are booming in the north of Scotland

FOR years, city-dwellers have admired both the natural grandeur and the majestic emptiness of the Scottish Highlands. But the moors and glens are not quite as empty as they used to be. The population of the Highlands is growing, and the area is enjoying a property boom.

With the exception of a few truly remote towns such as Wick and Thurso, property prices have been rising throughout the Highlands—by 24% last year, well above the British average of 14%. “In my 25 years in the property business, I have never known a rise of that level before,” says Gerald Cooper, chairman of the Highland Solicitors' Property Centre, a trade body. A four-bedroom seaside house and cottage in Plockton, near Skye, sold for £557,000 ($1m) earlier in the year. The asking price was £430,000. “Anything at the water's edge attracts the most enormous interest,” he enthuses.

One reason is the way housing booms ripple out slowly from London. Another is immigration. Scotland's population has fallen by 1% since 1995, partly because of a low birth rate and partly because of emigration. Now the population movement seems to have reversed. There is a net inflow into Scotland, and the Highlands are one of the hotspots. Last year a net 1,300 people moved in. That may not sound much, but the Highlands are so empty that the newcomers boosted their population by half a percentage point.

So why are people moving north? One reason is that Inverness, the region's biggest population centre, is booming. A new university and better roads have cemented its position as the Highlands' metropolis. CogentSI, an economics consultancy, says that the city's economy has grown by 3.9% a year over the past decade, more than twice the Scottish average.

Nor has the boom attracted only lowland Scots. Around half of the new Highlanders hail from England and Wales. Because house prices are still higher south of the border, they can move north, retire and still have cash to spare. But retirees make up only about a third of the immigrants; research by Highlands and Islands Enterprise, the region's economic development agency, shows that about 40% were moving because they wanted to work in more tranquil and attractive surroundings.

Local officials claim that television has done its bit. The Highlands have starred in recent dramas, such as

the BBC's “Hamish MacBeth” (filmed in Plockton) and “Monarch of the Glen”. Immigrants apparently cite them as part of the attraction. Tourism has an effect, too. Holidaymakers sometimes turn into residents. Stephanie Bunyan and her husband, from Surrey, in England, spent three years looking for a retirement house. “We have gone on holiday to Scotland for many years and have just fallen in love with it,” she says.

But not everyone is happy. Low-paid workers like farmers and tour guides complain that they are being priced out of the housing market. The Highland Council, the local authority, says homelessness has gone up and public-sector workers are harder to recruit.

Though there are signs that house prices are beginning to peak, the Scottish Executive is adding to the problem. It has decided to move about 250 jobs at Scottish Natural Heritage, a conservation quango, from Edinburgh to Inverness. Those workers will help keep the northern property boom going just a little longer.

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About sponsorship

Universities

Bad chemistry

Nov 25th 2004
From The Economist print edition

High demand is no guarantee that a university course survives

Get article background

PLANNED economies are bad at matching supply and demand. That was well-demonstrated by the collapse of communism, but clearly not conclusively enough. Over-subscribed university courses are closing for the same reason that Poles used to queue for bread: because state-controlled prices and subsidies don't make it worthwhile meeting consumer needs.

On November 29th, dons and students in Cambridge will be demonstrating against the mooted closure of the university's architecture department. Its teaching is highly rated and it has 11 applicants for each place. But, according to Marcial Echenique, the department's acting head, it costs £10,000 ($19,000) per year to teach a student, while the fees, set by the government, are just over £1,000 and the state subsidy £4,000. The rest comes from research funding. This has just been cut sharply, leaving a £400,000 hole in the accounts. The university, which makes a big loss on undergraduate teaching and has a £9m accumulated deficit, is not in a state to plug the gap.

If Cambridge shuts down architecture, it will be the first time it has closed a department. But other universities have already faced a similar squeeze. The most vulnerable courses are the expensive ones. Arabic and Persian are endangered; other hard languages are no longer taught anywhere. Durham this year announced it would be closing its main courses in Japanese and Chinese.

The story in science, particularly chemistry (which costs £7,000-12,000 a year to teach), is even bleaker. The University of Exeter this week announced that it would close its chemistry department—the 28th to do so in the past ten years, according to the Royal Society of Chemistry. Just as with Cambridge's architects, the course is popular: it has five applicants for every place, and numbers rose by a fifth last year. But there is too little research money coming in to pay for the students: keeping going would cost £3m a year.

It is hard to criticise the government for concentrating research funding on the best-rated places (if dons divert money to undergraduate teaching it hardly signals a single-minded drive to reach the frontiers of knowledge). But stopping undergraduate teaching of important but costly subjects is not what the government wants. Charles Clarke, the education secretary, is about to ask the body that funds higher education to investigate further.

One solution is for universities to take more foreign students, who pay full fees. The London School of Economics, for example, balances the books on undergraduate teaching by taking half of them from outside the European Union (EU). At Cambridge, only 10% of the architecture students are full-fee foreigners. Yet the Architectural Association in London, a charity without state funding, offers undergraduate courses at a flat-rate £12,300 a year and fills 60% of its places from outside the EU.

The logical way out is to make home students pay more. University fees will be allowed to rise after 2006, but only to £3,000. That may cover cheap courses in bad universities, but will not pay for expensive teaching in good ones. Meanwhile, Britain's only private university, Buckingham, which charges undergraduates £11,580, is considering expanding its science teaching in response. As with communism, the economics is obvious: the problem is political.

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Education

Chalk and talk

Nov 25th 2004
From The Economist print edition

Can chains of private schools shake up British education?

Get article background

PRICEY and complacent, British fee-paying schools are rarely businesslike. Entrepreneurs find that tempting: why not run lean schools, with proper marketing and customer service, and turn a profit?

The latest entrant to the market is headed by Britain's best-known critic of state education, Chris Woodhead. As chief inspector of schools, he enraged the educational establishment by attacking political correctness, trendy teaching, bureaucracy and waste. He has been saying for years that he would launch a chain of low-cost, for-profit schools.

On November 24th there was the first sign of something actually happening: a new company chaired by Mr Woodhead, Cognita, announced its existence, and the acquisition of its first school, Quinton House in Northamptonshire. It plans to buy 20 schools eventually.

Previous newcomers have found the market disheartening. Nord Anglia, once Britain's top private education outfit, has sold its ten British schools in order to concentrate on schools abroad. Asquith Court, owned by WestLB, a German bank, is trying to unload its 13 schools to concentrate on its more lucrative nursery business. GEMS, a recent entrant backed by a Dubai-based tycoon, which wants to open a chain of hundreds of for-profit schools, has lost most of its top management amid rows about strategy.

David Starkie, an education economist, says Mr Woodhead's venture looks too similar to existing schools in fees and style of teaching: innovative pricing models or efficient new ways of using staff are needed to make money. GEMS talks a lot about the latter.

Planning restrictions make building new schools hard, but buying them is tricky too. Most fee-paying schools are charities. Of the few for-profit ones, many are unattractive. “I looked at 60 and bought four,” says an entrepreneur. Quinton House had been rejected by others: although in a good catchment area, expanding it will be hard.

The real profits may be elsewhere. GEMS is trying hard to sell management services to schools. Alpha Plus, which runs 16 schools and is planning to buy another three, thinks the money is at the top end of the market. BPP, a publicly quoted company that runs vocational courses for adults, is expanding its sixth-form college: “a natural feeder” says Charles Prior, its boss. He wants to recruit 16-year-olds from east Asia.

Mr Woodhead is better known for criticising things than for running them. The rest of his team looks thin. The company declines to explain how it will overcome the obstacles that have so far defeated others.

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About sponsorship

Public finances

Deficit today, tax rise tomorrow

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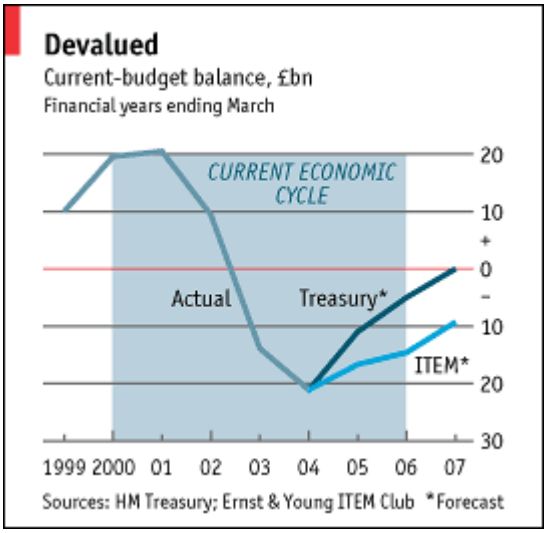
Things aren't going the chancellor's way any more

AS BRITAIN'S public finances have slid into the red in Labour's second term, Gordon Brown, the chancellor of the exchequer, has been in denial. Successive Treasury forecasts have been over-optimistic about the budgetary outlook.

In his 2002 budget, for example, Mr Brown forecast net borrowing of £13 billion in 2003-04. A year later he said it was going to be £27 billion. It turned out to be £35 billion—3.1% of GDP.

On December 2nd Mr Brown will present the Treasury's latest forecasts. It is an opportunity for a chancellor who has made so much of his fiscal prudence to take a reality check. That reality is a persistent shortfall in the public finances.

Mr Brown focuses not on the public sector's borrowing, which includes the financing of net investment, but on the gap between current revenues and current spending. Over the economic cycle, he has bound himself to meet the “golden rule” of borrowing only to invest. This means that the natural tendency for the government to run current-budget deficits when the economy is weak must be offset by surpluses when the economy is strong.



The Treasury judges that the current economic cycle started in 1999-2000 and will end in 2005-06. In the first two years of the cycle, the government ran substantial current-budget surpluses of £20 billion a year (see chart). These appeared to give Mr Brown ample leeway to meet his golden rule even when the public finances first started to deteriorate.

However, by the time of this year's budget, hefty current-budget deficits in the past two financial years had eaten into the reserve of earlier surpluses. As a result, Mr Brown's chances of meeting the golden rule rested heavily on a marked improvement in the current budget this year and next. Fortunately for him, the Treasury forecast that the deficit would shrink from £21 billion in 2003-04 to £11 billion in the present financial year and £5 billion in 2005-06. This was sufficient, the Treasury estimated, to meet the golden rule.

Since then, however, the public finances have deteriorated instead of improving as the Treasury had forecast. In the first seven months of the financial year, which started in April, the current-budget deficit was £17.2 billion compared with £15.6 billion in the same period last year. Overall borrowing has also been higher.

The Institute for Fiscal Studies says that, if current trends continue, the government will run a current-budget deficit in 2004-05 of £23 billion—double the Treasury's budget prediction. The ITEM Club, which uses the Treasury's economic model, is forecasting a deficit of £17 billion with little improvement in 2005-06. “On the basis of this forecast Mr Brown will break his golden rule,” says Peter Spencer, ITEM's economic adviser.

The chancellor is in fiscal trouble because tax revenues are not rising as fast as the Treasury had predicted. In particular, growth of corporation-tax receipts has been lower than it expected.

On December 2nd, Mr Brown will put the best gloss on the fiscal numbers. He could still meet his golden rule, for example by changing the dates of the economic cycle. But if big deficits persist, taxes seem bound to rise after the election.

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Transport

Bonds and buses

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Financiers like London's new transport bond. So should passengers

AFTER some hair-raising misadventures in the 1980s, Britain's local-government bond market went dormant. But that's now changing. Transport for London (TfL), which runs the capital's transport for the mayor, is to issue £200m in 30-year bonds. Other issues will follow, of varying terms, to a total of £3.3 billion over the next six years.

In the long term, if other local authorities follow London's example, borrowing for infrastructure against income from fares and road pricing, bonds could revolutionise local transport. In the nearer term, life should improve for London's long-suffering bus and tube passengers. The bond issue also shows that public transport is no longer the plaything of socialist fantasists, but stable enough to gain an AA rating from sober-minded credit analysts.

The government is in favour of the idea: its say-so was needed for the issue to go ahead. Credit analysts like the sums: fares and other revenues currently bring in £2.6 billion of the total £5.5 billion budget, and central government adds another £2.2 billion. Over time, fares are due to rise. By 2010 they will bring in £3.6 billion, against a government grant of £2.6 billion.

Some of that subsidy—around £1 billion—is earmarked for investment in the Tube under the controversial public-private partnership (PPP) which hands maintenance over to private companies. But there are a lot of necessary improvements, such as relieving congested stations and building new bits of line, which the PPP doesn't cover. The bond issue will help TfL invest in them, and also cut costs: it can buy buses, for example, instead of leasing them.

What would really make a difference, though, is not TfL's tweaks, but a final decision by the government on the much-postponed £10 billion Crossrail project, linking Heathrow to the City and east London. Bonds may help finance it. A decision on Crossrail is now definitely, probably, maybe, perhaps, expected before next year's general election. Rob Bain of Standard and Poor's, a ratings agency, notes that TfL's finances are more flexible than Crossrail's. Most of the planned schemes are small. If passenger numbers or other conditions change, TfL can react quickly. Once Crossrail starts digging, it has to finish—and that's more risky.

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Counting people

Where is everybody?

Nov 25th 2004
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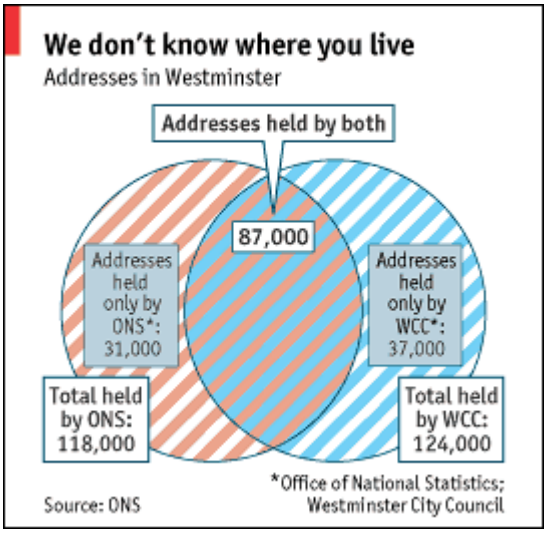
Addresses should be simple. But they are a costly muddle



HOW many people are we dealing with, and where do they live? That should be a simple question in government or business. But in Britain, it's oddly hard to answer because of the lack of a single, reliable list of addresses for people, firms and buildings.

The mess is confusing and costly. Estimates of how many people live in a particular area can vary by up to 10%, depending which central or local government data are being used. The census in 2001 wildly miscalculated the number of people living in Westminster, in central London, because the central address register being used didn't match the local one (see chart). That skews all sorts of government grants and payments.

It also means that local councils may be failing to collect taxes properly. "I was looking for office accommodation in central London and was told 'these offices are very good because they haven't been valued for council tax'," recalls John Thornton. He was most interested: he heads a government body trying to improve efficiency in local government. Tony Vickers, a geographer, estimates that £1 billion in local taxes may be uncollected because of bad address data. The average local council wastes the equivalent of 15 employees' time matching different address lists, reckons Mr Thornton.

British addresses are a hodge-podge: some bits, like the name of a house, are chosen by the owner, and can change suddenly: renaming your house is easy. The street name, if there is one, is chosen by the local council. The Royal Mail picks the name of the town, for post-sorting convenience rather than logic or geography. Buildings that receive no mail have no address, although they may be taxable, catch fire, or need some other outside attention. The human side is complicated by shifting populations, especially in inner-city areas, where many dwellings may share one letter-box.

The answer is a single, comprehensive, up-to-date list. With government encouragement, local authorities have been working hard on compiling Local Land and Property Gazetteers (LLPGs). That is bringing big efficiency gains. But these would be even greater if these were linked into a national register.

That was originally planned for April this year. But it isn't happening, to the annoyance of geographers. They blame the Ordnance Survey (OS), the state-owned map-making agency, which argues that the LLPG data includes its own, copyrighted map references. It says its first concern is selling this intellectual property for a profit, not worrying about wider issues.

"OS is such a dominant player in the market, everyone's scared. If you take them on you lose and lose big," says one map-maker. The fear among geographic-information firms is that the Ordnance Survey is planning to hog the whole, potentially very lucrative, business of accurate addresses, with the government's tacit consent. At least one such firm is planning to appeal to the government competition watchdog, and is talking to MPs in the hope of invoking their scrutiny too.

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Railways

Off track

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Subsidy-gobbling rural railways get another chance

Get article background

CARTING fresh air around, argues Alistair Darling, the transport secretary, is a poor use of public money. So why not close the country's least-used and most-subsidised railways, perhaps replacing them with buses? That's too controversial: hundreds of branch lines and thousands of stations were closed in the 1960s, and many people still mourn them.

Instead, the government is now rethinking the future of 56 lightly-used rural branch lines, which consume £300m in public subsidy. Every passenger on Wessex Trains, in south-west England, is subsidised by an average of 17.9p per kilometre. But passengers on the most successful routes, like the Gatwick airport line, pay back 6p per kilometre to the public purse.

So the government is trying to change the way that the loss-making rural railways are run, by encouraging bodies called Community Rail Partnerships (CRPs). Some 40 of these exist already, bringing together local authorities, do-gooding groups, rail nuts and other people who want to keep their local railway going. In past years, these have successfully drummed up new business for the trains they love. They have even reopened some previously closed or mothballed lines. The government now hopes that with more state backing they can halve the subsidy for rural railways.

It may be worth a try. But the idea highlights possible solutions to the railways' wider problems: cost and bureaucracy.

The CRPs are fierce critics of the railways' bloated costs. Paul Salveson, who runs the partnerships' national office, says that building a new small station in Germany costs as little £240,000; overly high standards, poor project management and other inefficiencies mean that a comparable project in Britain would cost £1.5m.

Bringing in outside volunteers for cleaning and light maintenance work can also cut costs. Revealingly, Bob Crow, a railway union leader, was quick to attack the new plan for just that reason.

A second big advantage is flexibility. Currently, altering services to meet changes in demand is very cumbersome. Yet branch lines in tourist areas may want to run lots of services in summer, and few in winter. Giving the CRPs, rather than rail regulators, the say-so on such changes will mean faster and better decisions.

In the long run, the government wants to decentralise all decisions about local transport subsidies. If the rural railways are still loss-making when that day comes, even scenery and sentiment will not be enough to keep them chugging.

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Bagehot

Crying wolf

Nov 25th 2004
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Accusations that Tony Blair is creating a climate of fear are missing the point

IT WAS one of the more memorable images of the presidential election campaign: a pack of prowling wolves in a forest and a suitably flesh-creeping voice-over declaring, “weakness attracts those who are waiting to do America harm.” In other words, a vote for John Kerry was also a vote for Osama. Whether or not George Bush's triumph in the end owed more to “values” than insecurity, Karl Rove wasn't taking any chances. And if the reaction to this week's Queen's Speech, setting out the government's legislative programme for the new session of Parliament, is to be believed, the politics of fear has also arrived in Britain.

According to Simon Jenkins, writing in the *Times*: “We shall have dread at the dispatch box and heebie-jeebies at the hustings. The Queen's Speech is not just dumbed-down politics, it is into-the-basement and out-of-the-gutter politics.” Tory and Liberal Democrat spokesmen chorused that the government was guilty of creating “a climate of fear” in the run-up to the election.

The trigger for this outrage was the government's plans to introduce bills to bring in identity cards by 2008, to establish something called the Serious Organised Crime Agency (inevitably dubbed the “British FBI”), to allow no-jury courts in some terrorist trials and to make wire-tap evidence admissible in court. The first two may become law before May, when the election is expected, while the rest will form part of Labour's manifesto and be subject to further consultation.

Courts without juries will always be controversial—and so they should be, even if the government can point to the high quality of justice meted out by the Diplock courts in Northern Ireland. Reasonable people can also have opposing views about the worth of identity cards and the principles involved. But if the charge is that the government is trying to scare people into voting for it by concocting a raft of repressive measures to deal with a cynically exaggerated threat, it is a grave one. By the same token, if the accusation is largely false, it is an unusually irresponsible one to make. What does the evidence suggest?

While there is nothing here to compare with Mr Rove's wolves, David Blunkett, home secretary and sponsor of the contentious legislation, certainly enjoys playing the tough guy. He often grumbles about the “liberati”—people who, he says, put abstract notions of civil liberties above the duty to protect a liberal society from those who would destroy it.

It is also true that Tony Blair is determined to prevent the Tories from occupying territory to Labour's right. Last week, the Conservative leader, Michael Howard, expressed his frustration over Mr Blair's appropriation of traditional Tory themes. Both Mr Blunkett and Mr Blair cite the rise of Jean-Marie Le Pen in France and Pim Fortuyn in the Netherlands as examples of what can happen when left-of-centre parties ignore security issues. They argue that effective security measures are the essential backcloth to pursuing progressive policies.

This week Peter Hain, leader of the House of Commons, suggested that Liberal Democrat and Conservative opposition to the government's plans for dealing with terrorism and crime meant that people would be safer under Labour. And with what looked like convenient timing, a story about the thwarting of an al-Qaeda plot to destroy Canary Wharf skyscrapers with hijacked planes popped up in the newspapers, attributed to an “authoritative senior source”.

Compared with the stuff that George Bush's people put out about the dangers of voting for Mr Kerry, Mr Hain's comments looked mild-mannered to the point of wetness. But the fury that they and the Canary Wharf story aroused showed why the government has to tread warily. If Mr Blair thought he could win

points by scaring voters witless, it is possible he might be tempted to try it. But he is much less sure than Mr Rove that it would be clever—with good reason.

You can't scare us

For one thing, opinion polls indicate that British attitudes towards terrorism are more phlegmatic than American ones. Britons may be fooling themselves about the impact that an atrocity on the scale of September 11th would have on their society, and comparing al-Qaeda to the IRA may be a mistake, but most assume that life will continue much as before even if the worst happens. A government that went on too much about terrorism would be regarded as excitable.

That's a risk Mr Blair can't take. His trust ratings fell more sharply than Mr Bush's did after it became clear that there were no weapons of mass destruction in Iraq; and he therefore knows that anything he says about the threat of terrorism is tainted unless something apocalyptic happens. Claims based on intelligence sources are likely to arouse particular suspicion, and metaphors involving wolves to be avoided at all costs.

Iraq has caused a further problem. A YouGov survey for the *Daily Telegraph* last month indicated that 56% think that the war has made them less safe compared with 8% who think it has made them safer. The reality is more complicated, but still unpalatable for Mr Blair: in the short term, Iraq has deflected the attention of terror groups from western targets, but in the longer term it may have increased the risk of attack by radicalising indigenous British Muslims. If there were such an attack, the government might just benefit from a patriotic instinct to rally to the incumbent. But the Madrid bombings last March cast doubt on that idea. Mr Blair knows that the politics of fear could work as well against him as for him.

There is actually a much simpler reason for what the government is doing. Mr Blair and Mr Blunkett believe in the threat and are afraid that something awful may happen. The one thing they don't want anyone to be able to say is, “You didn't do enough to protect us.”

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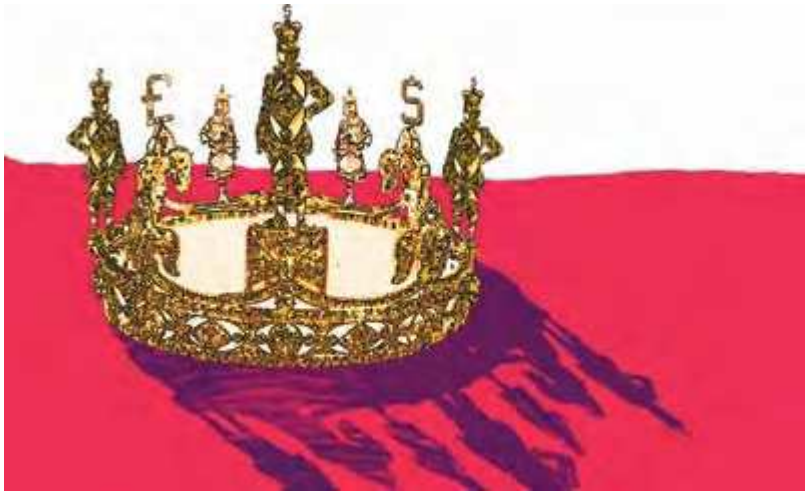
The new kings of capitalism

Nov 25th 2004
From The Economist print edition



In two decades, private-equity firms have moved from the outer fringe to the centre of the capitalist system. But, asks Matthew Bishop, can they keep it up?

"IF YOU made 'Private Equity: the Movie', then Michael Douglas would have to play Schwarzman." The head of one multi-billion-dollar private-equity firm is talking about the head of another, the Blackstone Group's Steve Schwarzman. "I'm joking," he adds quickly, "Steve and I are good friends." Perhaps he realises that comparisons with the fictional Wall Street banker famously portrayed by Mr Douglas, Gordon "greed is good" Gekko, are not what his industry needs just now. In fact, Hollywood has already set its sights on the men who run this enormous, relatively unaccountable pool of capital. This year, the Carlyle Group, a huge private-equity firm, has been vilified in Michael Moore's film "Fahrenheit 9/11", as well as being named as the inspiration for a fictional private-equity firm that tries to install its brainwashed candidate as American president in the remake of "The Manchurian Candidate".

Yet to study firms such as Blackstone is as good a way as any to find out what is going on at the sharp end of capitalism today. Hedge funds may be sexier, at least for now, but it is surely Mr Schwarzman and his peers in the private-equity industry who control the really smart money and wield the lasting influence. This survey will explain what they do, what challenges they face and what effect they have on the world of business at large.

In 1985, when Blackstone was founded by Mr Schwarzman and Pete Peterson, a former commerce secretary under Richard Nixon, private equity was a cottage industry that few people had heard of. There had always been family-owned private firms, but family owners did not usually aim to sell off the business; they passed it on to the next generation.

Until the late 1970s, the main activity in private equity—buying shares in private companies in the hope of selling them at a higher price later—had been carried out mostly by the investment arms of a few wealthy families, such as the Rockefellers and Whitneys in America, and had generally been confined to venture-capital investment in small, fast-growing businesses. America's venture capitalists have become the envy of the world for developing firms such as Intel and Google from nothing more than a bright idea into big, successful companies. But these days less than one-fifth of the money the industry raises goes on providing venture capital for young firms. Much the larger part of private-equity money is spent on buy-outs of established companies.

The first of today's big private-equity firms, Warburg Pincus, was formed only in the late 1960s, and had to raise money from investors one deal at a time. By the late 1980s private equity had grown big enough to be noticed by the general public, but it made hostile headlines with a wave of debt-financed

“leveraged buy-outs” (LBOs) of big, well-known firms. The industry was cast in the role of irresponsible “corporate raider” attacking from the wilder fringes of capitalism. A bestselling book by Bryan Burrough and John Helyar about the $25 billion battle in 1988 for RJR Nabisco branded two private-equity firms, Forstmann Little and Kohlberg Kravis Roberts (KKR), as “Barbarians at the Gate”.

Today, the private-equity industry has moved from the fringe to the centre of the capitalist action. In the process, the leaders of private equity have earned themselves both wealth and respect—if not always respectability. The fabulously rich Mr Schwarzman pops up in the society gossip pages for such things as paying a record $37m for a Manhattan apartment and for demolishing his Florida mansion, allegedly without permission. He is often tipped as treasury secretary in a Republican administration.

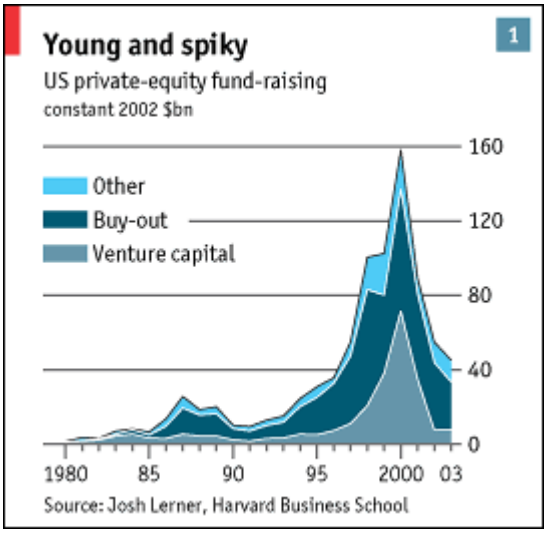
A magnet for the best

In the 1980s private equity was a place for mavericks and outsiders; these days it attracts the most talented members of the business, political and cultural establishment, including many of the world's top managers. Jack Welch, the legendary former boss of GE, is now at Clayton, Dubilier & Rice. Lou Gerstner, who revived IBM, is chairman of Carlyle. Even Bono, the saintly lead singer of rock band U2, is now in the business.

Moreover, as Hollywood has noticed, private-equity firms have become the employer of choice for politicians and government officials returning to the private sector. Blackstone has hired Paul O'Neill, until recently America's treasury secretary. Carlyle has provided lucrative work for numerous luminaries, including George Bush senior, Fidel Ramos, a former president of the Philippines, John Major, a former British prime minister, and Arthur Levitt, a former chairman of America's main financial-markets regulator, the Securities and Exchange Commission (SEC).

Private equity's transformation into a mainstream industry has been greatly helped by a fundamental change in the sort of deals it does. In the late 1980s, funds often borrowed to the hilt to pay for buy-outs, many of which were seen as hostile by the management of the intended targets. Nowadays the buy-out firms' deals involve much less debt. When KKR bought America's Safeway supermarket chain in 1986, it borrowed 97% of the $4.8 billion the deal cost it; now a private-equity firm would typically have to stump up around one-third of the purchase price.

Hostile deals are now extremely rare. Even Britain's Philip Green, one of a small band of powerful individual private-equity financiers, declined to go hostile this year in his bid to buy Marks & Spencer, a British retailer. Indeed, big companies that would once have turned up their noses at an approach from a private-equity firm are now pleased to do business with them. Royal Dutch/Shell, a troubled oil giant, has been negotiating the sale of its liquefied-natural-gas business for $2.45 billion to KKR and Goldman Sachs Capital. Some companies even team up with private-equity firms, as Sony recently did with Texas Pacific Group (TPG) and Providence Equity Partners to buy MGM, a film studio.



Having largely shed the image of corporate wreckers, private-equity firms can now plausibly describe themselves as providing a safe haven in which firms can pursue long-term growth, sheltered from the short-term storms of the public stockmarkets. This role is all the more important because both venture capitalists and buy-out firms work increasingly with firms undergoing big changes. Well-known firms that have recently been “nurtured” by private equity include Burger King, Polaroid, Universal Studios Florida, Houghton Mifflin, Bhs, Ducati Motor and the Savoy Group.

Private-equity firms can also reasonably claim to offer a solution (though an expensive one) to the corporate-governance problems that have blighted so many public companies. “If you examine all the major corporate scandals of the past 25 years, none of them occurred where a private-equity firm was involved,” noted Henry Kravis, one of the founders of KKR, in a recent speech. Private-equity firms, he said, are “vigilant in our role as owners, and we protect shareholder value.” On the other hand, if there were any impropriety in a private company, the public might not get to hear about it.

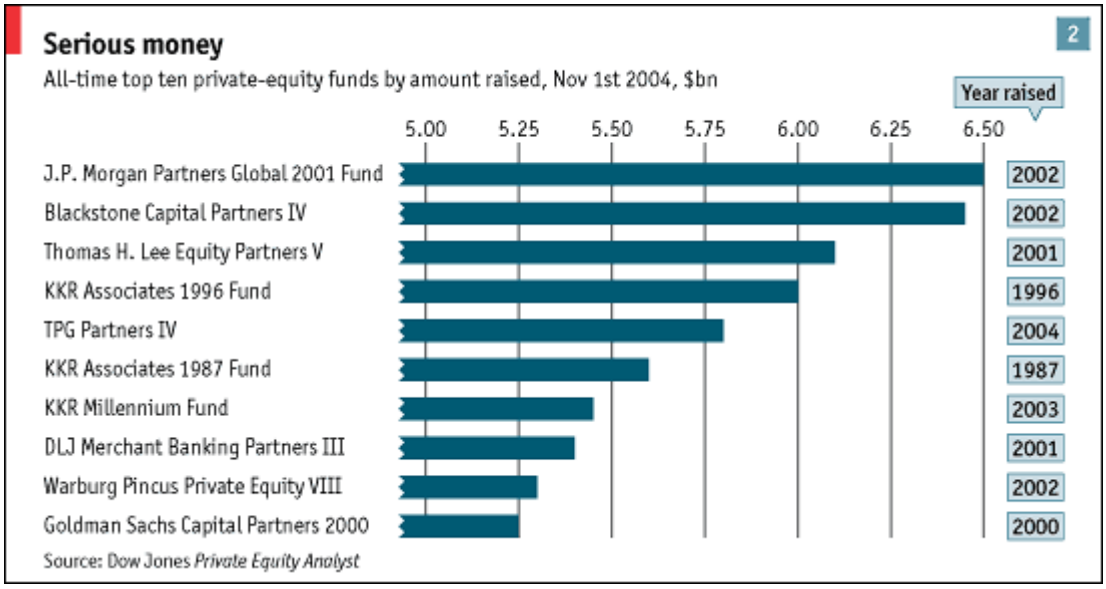
Clearly, private equity is now a big business. In Britain, for instance, one-fifth of the workforce outside the public sector is employed by firms that are, or have been, invested in by a private-equity firm, according to the British Venture Capital Association. Worldwide, there are more than 2,700 private-equity firms, reckons Goldman Sachs (maybe many more, because in this private world small firms can easily drop below the radar screen). As pension funds, endowments and rich individuals have become increasingly keen investors, the amount of private equity has soared. In 2000 alone, the peak year so far, investors committed about $160 billion to private-equity firms (much of it to venture capital), up from only $10 billion in 1991.

At the same time, there has been a dramatic growth in the size of private-equity funds, and in the size of the top firms that manage them. Most private-equity firms raise funds as limited partnerships. The firm is the general partner that manages the fund and gets paid an annual fee (a percentage of the money in, or promised to, a fund) and later a large slice of any profits; outside investors (who often lock up their money for up to ten years) become limited partners who share only in the profits.

In 1980, the world's biggest fund (KKR's) was $135m. Today there are scores of funds with over $1 billion each. J.P. Morgan's latest one is currently the biggest, at $6.5 billion, ahead of Blackstone's (see chart 2, next page); Permira has Europe's largest, at around $6 billion at today's exchange rate. A $10 billion fund can be only a matter of time, if only for the fabulous annual fees.

Blackstone, which started life as a two-man band working from a single room, has become, in its own words, “a major player in the world of finance”. It employs over 500 people in plush offices in New York's Park Avenue, Boston, Atlanta, London, Paris and Hamburg. The 35-40 firms in which it has a private-equity stake together have over 300,000 employees and annual revenues of over $50 billion—which, were they lumped together as a single conglomerate, would make Blackstone a top-20 *Fortune* 500 company. Other big private-equity firms can point to similar numbers. TPG's portfolio of firms has 255,000 staff and collective annual revenues of $41 billion; Carlyle's has 150,000 workers and revenues of $31 billion.

Yet the private-equity industry must now grapple with tough new challenges. These fall into three broad and overlapping categories: generating good financial performance; coming up with winning strategies in a rapidly maturing industry; and becoming more accountable to the public, and thus less private.



There are few industries in which the gap between the best and the rest is as large as in private equity. The top firms have delivered far better returns to investors than the stockmarkets have done, but the average private-equity fund has actually produced worse results (after fees) than public equities. That includes buy-out funds as well as the venture-capital funds that destroyed so much capital during the tech bubble a few years ago.

In future, the industry may find it hard to match even this not-too-glittering past performance. Private equity may become a victim of its own success. Techniques such as seeking to maximise cashflow, using debt astutely and paying managers with shares, which were novel when private-equity firms first introduced them in the 1970s, have become standard business practice. As Mr Kravis put it in his recent speech, “Everything we have accomplished in driving corporate excellence makes it harder for us to

achieve the returns that our investors expect from us."

A crucial factor will be whether private-equity firms can genuinely improve the companies they buy. Another will be how easily they can dispose of their investments. Without an "exit", there can be no profits. Two main exit routes—selling a firm to a big corporate buyer or floating it on a public stockmarket through an initial public offering (IPO) of its shares—have recently been much harder to pursue than in the past; and increasingly popular alternatives, such as selling to another private-equity firm, are becoming controversial.

Much will depend on how investors respond. On one hand, many have been disappointed at private-equity firms' average past performance; on the other, at a time when bonds and public equities are delivering historically low yields, the high returns generated by the best private-equity firms look increasingly enticing. European institutional investors, which have traditionally invested little in private equity, are beginning to show more interest. If investors pump more capital into an industry that arguably already has too much of it—especially now that hedge funds, flush with cash, are also piling into private equity—there is every chance of creating another bubble, hot on the heels of the one in venture capital.

Not only are good opportunities becoming harder to find, but being a maturing industry throws up other tricky issues. Many of the leading private-equity firms are still run by their founders, who are now getting to an age where they have to consider bowing out. As is often the way with charismatic founders, some may linger too long. And even when they go, the handover may prove highly disruptive as some of those passed over for the top job leave the firm. Nor can there be any guarantee that the next generation, clutching their MBAs, will inherit the deal-making magic of the founders.

Piggy in the middle

Will tougher competition and increasingly demanding investors cause the industry to consolidate? Sir Ronald Cohen of Apax Partners thinks that over the next decade the private-equity industry will polarise. At one end, a few big global industry leaders will emerge—"maybe three or four dominant brands with high returns"; at the other, small specialist firms will thrive. In the middle, however, many firms will find it hard to compete. His prediction is plausible, and the losers may include some famous names. Forstmann Little has already said that it will close in 2006. It made some awful telecoms investments during the bubble and has failed to resolve its succession problem.

Some of the biggest private-equity firms are already staking out different territories. KKR and Apax say they will continue to concentrate on private equity. But Blackstone and Carlyle have been adding other financial products to their portfolio. Blackstone, for example, which has long run property funds, is toying with starting a hedge fund as well as beefing up its existing business providing advice on mergers and acquisitions. Diversification, these firms hope, will help them to exploit their expertise and brands—and perhaps to generate a more stable stream of profits that may allow them to float on the stockmarket one day. But critics ask whether there is any real synergy between the different sorts of "alternative assets" they offer.

Will private-equity firms be able to maintain their privacy when transparency is increasingly expected in every walk of life? The answer may depend on politics as much as on economics. Most private-equity firms fiercely oppose greater transparency, arguing that it will rob them of their magic. Many tacitly accept that their performance will soon become subject to much more intense scrutiny, and that they will have to adopt sensible industry standards for valuing their portfolios. But they are desperate to avoid having to disclose details about the performance of individual firms in their portfolios. Such disclosure, they say, would quickly subject those companies to the same sort of damaging short-term pressures that they would face in the public equity markets.

But change is on its way, if only because of the growing amount of money being invested in private equity through public pension funds. In America, freedom of information acts have prompted some public pension funds to provide details of the performance of their investments in different private-equity firms, to the horror of most of the firms concerned. Yet, as Thomas Lee, founder of the eponymous private-equity firm, concedes, "We are using so much public money that we have an obligation if not to be transparent then to be a little less invisible than in the past." How much less invisible will be explored later in this survey. But first, a quick look at past form.

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Pick carefully

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From The Economist print edition

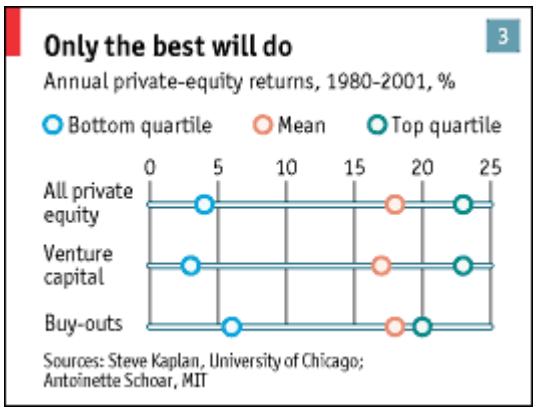
Some private-equity firms are much more successful than others

FROM its creation in 1976 to the end of 2003, KKR invested $18.4 billion. The firm calculates that these investments have increased in value to $49.7 billion, of which $39.3 billion has already been banked. Amid much fanfare, in the past 18 months it has returned $9 billion in cash to investors, beating even Carlyle's equally trumpeted cash return of $6.6 billion.

This sort of performance makes it easy to see why investors are so keen on private equity. Yet it has been the exception, not the norm—which has mostly been to lag behind even the public equity markets. And although KKR continues to proclaim that "private equity will outperform public equity and other investments over the long term," even the best firms may struggle to match their past success. KKR itself is now viewed in the industry as a shadow of its old self, concentrating increasingly on lower-risk, lower-return deals.

From 1980 to 2001, the average private-equity buy-out fund generated slightly lower returns to investors (after subtracting fees to general partners) than they would have obtained by investing in the S&P 500, according to a recent study by Steve Kaplan of the University of Chicago and Antoinette Schoar of the Massachusetts Institute of Technology. The median venture-capital fund also fell just short of matching the S&P, although an average of venture-capital firms weighted by how much capital each had invested beat it by a short head. However, gross returns (ie, before fees) on both buy-outs and venture capital did beat the S&P during that period—probably by a sizeable margin, fees being what they are (see article), concludes the study.

Mr Kaplan and Ms Schoar also found huge differences between individual funds. The top quartile of private-equity funds produced an annual rate of return of 23%, well ahead of the S&P; the bottom quartile earned investors only 4% (see chart 3). Other experts have come to similar conclusions. Greenwich Associates, a pension-fund adviser, says that typically "only the top 25 private-equity funds generate better returns than the S&P."



An even gloomier picture is painted by one of the most successful investors in private-equity funds, David Swensen, who has been chief investment officer of the now massive Yale University endowment since 1985. In a classic book, "Pioneering Portfolio Management", published in 2000, Mr Swensen is scathing about the performance of much private equity—particularly as the past two decades may have been uniquely favourable for private equity, with falling interest rates making borrowing cheaper, a

relatively small number of private-equity firms competing, lots of badly run companies to improve and a sharp rise in the multiple of share price to profits that investors in public stockmarkets would pay.

And even the performance of the few funds that did beat the S&P needs careful examination. Being much less liquid than public equities, private-equity investments should offer a premium over the S&P to justify the extra risk. This point is lost on some investors, who think that private equity is less risky because its reported value is much less volatile than public equities. But the main reason why private equity is less volatile is that it is only rarely revalued—and then usually in an unsatisfactory way. To say that private equity is less volatile and thus less risky is a bit like saying that the weather does not change much when you stay inside and rarely look out of the window.

It's done with mirrors

But there is a further common flaw in making comparisons with the S&P. Mr Swensen looked at 542 buy-out deals that were started and concluded during 1987-98. At first sight their performance looked impressive, with annual returns of 48%, compared with 17% if the money spent on each deal had been invested in the S&P for the same period of time. But most of these gains, Mr Swensen points out, came from heavy borrowing by buy-out firms seeking to multiply their private-equity bet.

If the same amount of debt had been used to multiply the investments in the S&P, the leveraged portfolio of public equities would have generated an 86% return, beating the buy-outs by nearly 40 percentage points a year—or nearly 50 points after fees. Yale took part in only 118 of the 542 deals, generating gross returns of 63% a year, comfortably beating (even after fees) comparably leveraged S&P investment returns of 41%. Not for nothing is Mr Swensen regarded as a private-equity genius.

Why did the average fund perform so poorly? Size does not seem to have been decisive, according to the study by Mr Kaplan and Ms Schoar. In venture capital, the larger funds of the 1990s tended to perform better than their smaller counterparts in the 1980s. But the opposite was true for buy-out funds, which struggled in the early 1990s even though they had got bigger. One possible explanation is that venture capitalists had much better investment opportunities available to them in the 1990s, as the technology revolution gathered speed, whereas buy-out funds were badly hit by the collapse of the junk-bond market in the late 1980s and the recession of the early 1990s.

Location may also have played a part. Various studies have shown that, during the 1990s at least, European-based private-equity funds (mostly concentrating on buy-outs) delivered better returns than their American counterparts. Possible causes range from less competition to better deals available because of corporate Europe's relative inefficiency.

Not only is there a large gap between the best private-equity funds and the rest, but their respective performances have also been remarkably consistent. Mr Kaplan and Ms Schoar found that the winners in private equity tend to keep on winning, and the bad firms stay bad—if they remain in business. This is in sharp contrast to mutual funds and, to a lesser extent, hedge funds, where star performers tend quickly to return to the average. If a private-equity firm's first fund performs well, its second and third will probably do likewise—even more so in venture capital than in buy-outs.

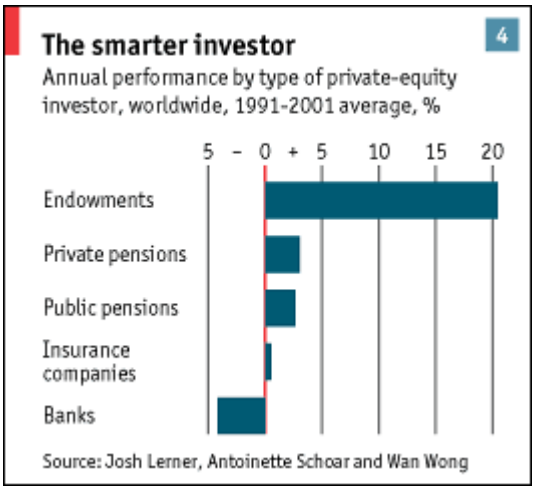
Why? Some private-equity firms may have better access to “proprietary” deals in which they are the only bidders, so their costs will be lower than if they had to compete for deals. But with the increased use of auctions in sales to private-equity firms, this has become a much less likely explanation for superior performance. More plausibly, venture capitalists with a reputation for successfully nurturing start-ups may be offered better opportunities. Or perhaps there are simply just a few people in private equity who are very much better at it than their rivals. There is, after all, only one Henry Kravis.

Mr Swensen argues that the deals Yale invested in produced better results than the rest of those he studied because his institution took a different approach to private equity. It invested in funds whose deals involved much less debt and much more attention to improving the operating performance of the firms concerned.

Another explanation for the poor performance of many private-equity firms may be the inadequacies of their main investors. The vast majority of capital going into private-equity funds comes from institutional investors of various kinds. Some sorts of institution seem to do a consistently better job than others at picking private-equity winners, according to “Smart Institutions, Foolish Choices?”, a fascinating new study by Ms Schoar with Josh Lerner and Wan Wong, both of Harvard Business School.

Among funds raised in the ten years to 2001, those that attracted investment by the endowments of universities and not-for-profit foundations did 14 percentage points a year better than the average fund. Funds picked by investment advisers (including funds-of-funds, which invest as limited partners in a portfolio of private-equity funds) and banks performed well below average (see chart 4). The more endowments invest in a fund, the better it is likely to perform; the more banks invest, the worse it is likely to do.

According to the study, these striking differences cannot be explained away by the fact that endowments have been involved in private equity for longer, and thus tend to get better access to new funds being raised by the leading private-equity firms. Endowments have been just as good at picking out new private-equity firms that subsequently go on to do well.



The most likely explanation is that the leading endowments have sophisticated, relatively well-paid staff who monitor performance carefully. Harvard's endowment reputedly paid two of its analysts $35m apiece last year. Advisers, banks and others who sell funds-of-funds may have financial incentives to maximise sales, but may not care how the fund itself performs.

Banks' in-house private-equity funds often perform poorly because of conflicts of interest: they may be made to invest in a company because the bank hopes to win other banking business from it later. They also pay their staff less generously than others. Indeed, banks are now quitting the private-equity industry, both because of poor past performance and because of tougher rules on how much capital they must set aside to cover the risk involved.

But even those private-equity funds that have done well in the past may find it harder to do so in the future, as the next article will explain.

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Highly leveraged

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A gravity-defying pay structure

NICE work if you can get it. The general partners who manage private-equity funds are lavishly paid. They receive an annual management fee, usually 1.5-2.5% of the fund's assets, and also get a share of any profits made from the fund's investments after the initial capital has been repaid to limited partners, a payment known as the “carried interest”. This is usually 20% of net profit, although some firms, particularly venture capitalists, set their “carry” as high as 30%.

As if that were not enough, some private-equity firms levy charges for things such as monitoring the firms in a fund's portfolio, ending the monitoring arrangement when the firm is sold, and even for providing some of the investment-banking services involved in buying or selling firms in the portfolio.

In the early private-equity funds, in America at least, the carry was taken on each deal that made a profit, not on the aggregate performance of a fund. So, as long as some individual deals were profitable, general partners could collect a carry even if the fund lost money overall. From the late 1980s, under pressure from limited partners, funds started to calculate the carry on aggregate profits—though some firms, including KKR, were slow to embrace this new norm.

In practice, American private-equity firms have often taken their carry each time a deal is profitably concluded—with the proviso that if the fund turns out not to be profitable overall, limited partners can claw back these payments. In Europe, general partners do not usually receive any carry until a fund has repaid all of the capital invested by its limited partners. Lately, private-equity general partners have become jealous of hedge-fund managers, who also have a “2-and-20” reward structure, but typically get their carry at the end of every year.

Intriguingly, private-equity firms have rarely tried to compete for capital by lowering their take, perhaps because investors might interpret it as showing a lack of confidence. Warburg Pincus cut its carried interest in the early 1990s, but no one followed suit. Barry Wolf, a private-equity lawyer at Weil, Gotshal & Manges, says that when the tech bubble burst, many people expected investors to put pressure on the payment terms of new funds. But instead of attacking terms, they took an all-or-nothing approach to investing in new funds: those raised by firms with a generally good record got oversubscribed, bad performers got nothing.

If it gets harder to make profits by investing, private-equity firms will probably try to earn bigger management fees by raising ever larger funds at more frequent intervals. Jon Moulton of Alchemy, a British private-equity firm, is puzzled: “A lot of people in the industry already make several million a year without having to perform. I can't understand why investors haven't put more pressure on fees.”

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Small expectations

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From The Economist print edition

Things are likely to get harder rather than easier

SOME of the ageing superstars of private equity dismiss current predictions that competition will drive down returns. They have heard it all before. “There are still lots of great deals out there,” says Thomas Lee. “The past couple of years have been a golden age for private equity.”

There is some truth in this. The years immediately following the tech bubble, the economic slowdown, the terrorist attacks of September 11th 2001 and the collapse of Enron offered plenty of opportunities for private-equity firms with the courage to invest. Soon after September 11th, several private-equity firms set up a clutch of catastrophe-risk insurance companies based in Bermuda, which have now been sold at a huge profit. “We should have bought everything in sight after 9/11,” says Mr Lee. “It needed minimum brains, maximum guts to do those deals.” At the same time, big companies such as GE and Tyco, which had hitherto been competing hard with private-equity firms for potential acquisitions, backed away from the market or even became eager sellers of non-core businesses.

Yet this period may prove to have been only a brief reprise of the high returns of private equity's early years, not a sign that the industry has put its troubles behind it. Nowadays even the best private-equity firms are mostly aiming to achieve annual returns of only 15-20% on their capital, down from 20-25% in the 1990s and over 30% in the 1980s—though in the buy-out business they still hope at least to double their money on every investment. Private-equity firms now talk much less about the absolute returns they expect to make. Instead, they promise better returns than those available in public equities—which, given the stockmarkets' miserable performance lately, may not be saying much.

Some make bigger promises than others. “We expect to do 2,000 basis points better than the market in all conditions,” says the boss of one big firm. Carlyle is aiming for 1,000-1,500 basis points above the market. Most firms, however, feel that investors would settle for 600 points better than the stockmarket as sufficient reward for the illiquidity and, perhaps, the greater risk of private equity.

For a variety of reasons, returns may fall short of even these modest targets. There is already lots of

capital chasing deals: some $100 billion has been raised but not yet invested, hedge funds are piling in and a new cycle of fund-raising is getting under way. So far, funds with a good reputation are finding a keen response from investors, especially in Europe: Allianz, Germany's biggest investor in private equity, has said that it is planning to invest much more. Bain Capital recently raised a $4 billion fund in only a few weeks instead of the usual few months.

In the past, private-equity firms were able to do a fair number of “proprietary deals” in which they had no competition. Now, even though the number of deals is increasing, all but the smallest firms are sold through a competitive auction organised by the seller's investment bank. Competition can be intense, with deals attracting from half a dozen to many dozens of bidders, and auctions almost always result in higher prices.

Profitable ploys

Private equity thrives on finding inefficiencies to exploit. Fees aside, there are several well-established ways for its firms to make money. The four main ones are:

•Improve the profitability of the companies they buy, so that they can sell them for more than they paid for them.

•Buy low, sell high. Some companies fall temporarily out of favour with investors, so their shares trade at a low multiple of their profits or cashflow. Private-equity firms can buy them and wait until the market is more bullish and multiples are higher (though they may find that there was a good reason for the low valuation). Valuation multiples also tend to rise as firms get bigger, so simply holding a business and letting it grow may boost its multiple from, say, six to eight over a few years.

•Break it up. Some businesses trade at a value that is less than the sum of their parts. They can be broken up and sold in pieces for more than the purchase price. Some part of the business may distract management from a company's core operation or drain scarce resources from it. Selling it off not only raises money but may also result in a more focused and therefore more valuable core business.

•Use leverage. Borrowing can multiply any gains made by the first three methods. A private-equity firm buys a company for, say, $100m. It pays for it with $10m of its own equity capital and borrows the remaining $90m. It later sells it for $110m. After repaying the debt, it has doubled its money even though the value of the firm has increased by only 10%. The risk, however, is that if things go badly and the private-equity firm is unable to service and repay the loan, its capital may be wiped out in the bankruptcy courts.

In practice, many private-equity firms deploy all these methods. But broadly speaking, in the 1980s, when debt was plentiful and target companies were not highly leveraged in the first place, private-equity firms concentrated more on finding undervalued assets, selling off the pieces and greatly boosting their yield with leverage. In the 1990s, the increasingly bullish stockmarket allowed such firms to benefit handsomely from rising price-to-profit multiples. Today, the firms may have to earn most of their money by improving the companies they own.

Standard practice

One problem is the commoditisation of many of the activities that gave private-equity firms a competitive advantage in their early days. When people such as Henry Kravis started doing deals, the effective use of leverage and the importance of cashflow was a mystery understood by only a few; now it is taught in every business school. Private-equity firms have become a huge source of business for all sorts of professionals, from consultancies, executive search firms and back-office companies (such as BISYS, the industry leader) to law firms and investment banks (Blackstone alone paid Wall Street firms around $700m in fees in 2003). As a result, the techniques of doing deals have become standardised. That has

lowered risk but increased competition by making it easier for less experienced firms to bid.

Ultimately, private equity is all about making a successful exit. The traditional solutions are either selling to a trade buyer (typically a company in, or trying to get into, the same industry as the firm being sold) or turning the firm into a public company via an IPO. In the past two or three years, both of these exits have become narrower than they were during most of the previous decade.

Many of the IPOs that took place during the tech boom subsequently melted down, so now investors have little interest in buying shares in start-ups without a record of profitability. Google's IPO earlier this year may have attracted a lot of attention, but it has not made investors much keener on other tech IPOs. Most private-equity firms believe that it will be years before the IPO market returns to the levels of 2000—if indeed it ever does.

At the same time, corporate buyers remain reluctant to make all but the most obviously sensible acquisitions. Under pressure from shareholders, their boards have come to regard the large number of ill-advised takeovers and mergers during the bubble years as evidence of corporate-governance failure during that period.

Helpfully, two new exit routes have opened up in the past few years. The first is recapitalisation. Recently a few second-tier banks have become much keener on lending to finance private-equity deals. They are now willing to value firms at much higher multiples of profits than even 12 months ago, and to lend against those values. Many private-equity firms have taken advantage of this to “recap”: increasing the amounts borrowed by the firms in their portfolios, then using the extra money raised to make dividend payments that the fund distributes to its limited partners.

Will this exit stay open for long? There are only so many times a firm can be revalued and recapitalised. Recaps are anyway only a partial solution, for the firm still remains in the hands of its private-equity owner. And it may not be prudent for banks to lend at such high multiples. It would not be the first time that their pursuit of loan origination fees has led to laxity in their credit judgments. When they or their regulators notice how lax they have become, this particular door may slam shut just as suddenly as the IPO one did.

The other currently fashionable exit strategy is for one private-equity firm to sell to another, a technique known as a “secondary buy-out”. (This should not be confused with the “secondary market” in which one investor can sell its limited partnership in a fund to another investor. This market is also growing fast.) Over the past two years, secondary buy-outs have accounted for a rapidly rising proportion of sales by private-equity firms.

Some observers view these “buy-outs of buy-outs” as evidence of the growing maturity and specialisation of the industry. Others wonder what they will get out of this game of “pass the parcel”. “The results of these deals may prove most disappointing,” says Michael Stoddart, a British private-equity veteran at Fleming Family and Partners. Anything the buyer could do to improve its acquisition may already have been done by the seller. And what is the benefit to the limited partner who has invested in both the buying and the selling private-equity firm and thus ends up still owning the firm that has been sold, minus the fees for the general partner of the selling fund? Some limited partners even worry that such deals may involve some mutual back-scratching, in which one firm buys from another on the understanding that the seller will later return the favour.

There is another exit that private-equity firms are increasingly having to think about: that of their top brass. As the industry has matured, so has its pioneering generation of leaders. The duo in charge of KKR, Mr Kravis and George Roberts, are around 60, as is Mr Lee. Teddy Forstmann of Forstmann Little is 64. Increasingly, limited partners—who, after all, must lock up their cash with private-equity firms for many years—want to know who will succeed the current bosses, and when. So, too, do the candidates who might take over. Lionel Pincus, now 73, lingered so long at Warburg Pincus that when he finally gave up operational responsibility, a whole generation of heirs apparent had left.

Some firms have embraced succession planning more willingly than others. The founder of Apax, Sir Ronald Cohen, set a mandatory retirement age of 60 long before he himself reached it. Apax now has a new chief executive, Martin Halusa, 49. At Permira, power has passed smoothly to a new generation. Mr Lee has delegated day-to-day responsibility for his firm to others. TPG's David Bonderman now describes himself as more a chairman than a chief executive. Blackstone has recruited an emerging next leader, Tony James.

The long goodbye

By contrast, Forstmann Little, which has failed to develop any potential successors to Mr Forstmann (and has also put in an abysmal performance recently), recently announced that it will go out of business when Mr Forstmann retires in 2006. Mr Kravis, for his part, plans to stay at the helm for many more years. He says that KKR has a deep bench of talent, so there is no doubt that the firm will thrive after him.

What should a founder be paid for giving up his partnership? Founders tend to have a large stake in their firms, so buying it could be a serious drain on the finances of the remaining partners. Apax's partners had a meeting to agree on what they regarded as a reasonable price. Other strategies for cashing in the founders' stakes, much discussed in private-equity circles, include selling the firm to a bigger financial institution, or floating it.

The trouble with replacing a set of highly charismatic founder-leaders is that their successors may seem less inspiring. As one limited partner put it, they will certainly “all be very bright and numerate, with MBAs, very analytical. But I worry they may be more like bank officers than deal-making geniuses.”

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Beating the mid-life crisis

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What private-equity firms are doing to win in a mature market

“PRIVATE-equity firms are only now starting to do aggressive branding,” says David Rubenstein, boss of the Carlyle Group, a top private-equity company that has probably devoted more thought to its brand strategy than anyone else in the industry. This task has been complicated by Carlyle's recent elevation to public enemy number one, on film by Michael Moore and, more thoughtfully, in Dan Briody's book, “The Iron Triangle”.

Carlyle's critics note that many former politicians have taken the company's shilling, and that some members of the bin Laden family and other Saudis not only invested in the firm but were attending its annual investors' meeting on September 10th-11th 2001. This, they aver, shows that Carlyle is at the heart of a worrying global military-political-industrial complex.

The company fiercely rejects such charges. It says that hiring politicians was not meant to secure deals; it was a marketing initiative intended to “help people get to know us”. This approach has been widely imitated, says Mr Rubenstein: “Every private-equity firm now has its former senior government official hanging around, but it got identified with us.” He says that, contrary to the firm's (un)popular image, “we are as ethical as any business in the world, and are proud that in over 17 years no government agency has ever fined us for anything.” The bad press, he says, seems to have had no effect on private-equity investors, a smallish group who hold the firm in high regard. “We are raising more money than ever, recruiting more people than ever, doing more deals.”

For what it's worth, Carlyle's rivals in the private-equity business also dismiss the conspiracy theories and, in a back-handed way, pay tribute to the firm's marketing prowess. Wooing the people in public-pension funds who invest in private equity may well be good policy. They tend not to be high-flyers, and may be influenced by rubbing shoulders with the great and good in a luxurious venue.

“Carlyle is the McDonald's of the industry—big, everywhere, schlocky,” says one well-known deal-maker. Carlyle, he notes, is always on the road drumming up money to fill the constant stream of new fund “franchises” it opens. The company currently manages 22 funds of various sorts; the industry norm is to start one new fund every few years, typically involving a laborious fund-raising process that often lasts the best part of a year. “Carlyle is about as in charge of the world as McDonald's is,” concludes the rival deal-maker.

Just like Carlyle, other leading private-equity firms now hope that establishing a strong brand will give them an edge. As private equity matures, they think, it will become like many other industries, with a

few leaders that can use their strong brands to charge higher prices, launch new products more easily, recruit top talent and attract the best business partners. Impressive past performance is likely to be a prerequisite for becoming a strong brand. But in an industry once dominated by lookalike generalists, the top firms are now pursuing very different strategies.

The main variables are the size of their funds and the degree of specialisation. Some have established a niche in particular kinds of deals or industries or geographical regions; others cover the whole range of private equity, or are even moving beyond private equity into other assets such as hedge funds. The market seems well aware of these distinctions. Increasingly, limited partners "divide funds into particular categories, sectors, types of deals, then go to the best of breed in each group," says David Thomas of Citigroup Venture Capital (a global technology-oriented buy-out firm, despite its name).

One crucial strategic choice is the size of deal to be pursued. It is fashionable to argue that competition is fiercest—and thus returns likely to be lowest—in the biggest deals, of $1 billion and up. These are in relatively short supply. All of them involve auctions among the largest, most competitive funds. Mid-sized deals are often seen as a better bet—more common and more diverse, and thus providing more opportunities for specialist private-equity firms.

Yet mid-sized deals are increasingly allocated by auction, too. The poorest performers in private equity are concentrated in this part of the market. "A lot of firms in the mid-market know they are never going to be able to raise another fund, so they're throwing their money around," says the boss of one of the firms that concentrate on bigger deals. Mid-sized auctions tend to involve many more bidders, perhaps dozens. Bigger deals are often fought out by no more than three funds or consortia.

Consortium deals—known as "club deals"—have become increasingly common. A recent example was the joint purchase in July by KKR, Blackstone, TPG and Hellman & Friedman of Texas Genco, an energy firm, for $3.65 billion. Some clubs include non-financial firms: TPG and Providence Equity Partners recently teamed up with Sony to buy MGM.

But club deals are controversial. On the plus side, a consortium can do bigger deals. Most funds have an upper limit on how much of their capital they can put into any one deal, typically around 10%. So even a $5 billion fund, assuming it could borrow, say, three times the equity it puts in, might not be able to bid more than $2 billion for any target firm on its own.

On the minus side, some sellers suspect big private-equity firms of forming (loose) cartels to make bidding less competitive. There is also the practical question of which member of the club will be in control of the company after it has been bought. Jack Welch, the former boss of GE, who now works for Clayton, Dubilier & Rice (CDR, see article), worries about what happens when the purchasers disagree about what needs to be done to improve the company, or when to sell it. But that risk does not trouble Mr Lee, whose firm is involved in lots of club deals. "All the top people in the big private-equity firms have known each other for years, and it is unlikely we are going to disagree fundamentally," he says. "Put the chance of a difference of opinion versus the opportunity to make lots of money, I'm prepared to take the chance."

Many of the most upbeat people in private equity today concentrate on small deals, not least because in this area there is little competition from thebig funds. The funds pursuing small deals tend themselves to be small. "There is a stark contrast between small private-equity funds—maybe $10m-50m, truly lean, often largely funded by the general partners, who have often been successful managers—and big firms that are really asset managers whose main expertise is fund-raising," says Roy Bingham of Health Business Partners, an investment banking firm specialising in small health-care-related deals.

Sentinel Capital, based in New York, goes for firms in the $25m-125m range. There are lots of them, the scope for remedying inefficiencies is much greater than in medium-sized and large firms, and competition for deals is less intense—though that may change as the mid-market funds become more desperate for promising opportunities. Indeed, says David Lobel of Sentinel, mid-market firms are already keen buyers of companies that Sentinel has acquired and knocked into shape.

The leading private-equity firms have long claimed to add value to the companies they have bought. As the industry matures, they say, operational improvements will become the main source of profits, so they are upgrading their methods. CDR hired "Neutron Jack" to add rigour to the oversight of firms in its portfolio. KKR now draws up a detailed "100-Day Plan" ("not three pages, a line-by-line blueprint") for a firm immediately after its acquisition, in which its in-house consulting firm, Capstone Consulting, plays a crucial part.

The rise of the specialist

“From now on, specialists will outperform generalists,” says Glenn Hutchins of Silver Lake Partners, an American private-equity firm specialising in large, mature technology companies, a sector in which “you really have to understand the companies you invest in”. Increasingly, all but the biggest firms are claiming to be specialists in particular sorts of deal.

And even some big firms are claiming to specialise in several things: for example, Apax says it has built expertise in six carefully selected industries. Electra Partners, a big British private-equity firm, says it specialises in finding firms with low growth and complex challenges that it thinks it can clean up and put on a faster growth track. Elevation Partners was launched in June by Roger McNamee, formerly of Silver Lake, and Bono, a rock star, to seek out deals in the media and entertainment industry. But specialisation itself is no guarantee of success: a private meeting with Bono persuaded investors to stump up $1 billion, but can his fund do better than experienced and equally specialised rivals?

Some firms are trying to differentiate themselves by aiming for a wider geographical spread. For most American private-equity firms, “going global” is shorthand for beefing up their continental European operations. Several have now established a foothold in Europe, having tried but failed a decade ago. This time round they have realised that to succeed in Europe, with its many languages, cultures and legal systems, they need a strong local presence, mostly of local staff. Conversely, European private-equity firms are not seriously trying to crack the American market.

Europe has seen far more buy-out deals than other parts of the world in recent years, a trend that is widely expected to continue. “In Europe, unlike America, there will be opportunities to exploit inefficiencies for years,” argues Graeme Johnson, European head of Deutsche Bank's private-equity-funds group. One reason, says Damon Buffini of Permira, is that whereas America has already unbundled most of its badly run conglomerates, Europe is only now starting to do so. But even in America, there are still a few opportunities to be found. Wilbur Ross, of WL Ross, for instance, made a remarkable—and remarkably lucrative—job of rationalising America's steel industry and shepherding it through the bankruptcy courts in 2002-03.

Asia has mixed appeal for private-equity firms. Most think that it has huge potential but are uncertain about their ability to take advantage of it. Many are now looking hard at Japan, following the success of Ripplewood and Christopher Flowers in buying Shinsei Bank out of bankruptcy, cleaning it up and floating it. Gillian Tett's gripping book about the deal, “Saving the Sun. How Wall Street Mavericks Shook Up Japan's Financial World and Made Billions”, makes it clear that foreign private-equity firms with brains, patience and connections can make a fortune in Japan.

Private equity is growing in India too. Gaurav Dalmia of First Capital India, a private-equity boutique, says this ranges all the way from big foreign funds negotiating equity stakes in large Indian public companies to Indian entrepreneurs returning from Silicon Valley to put their money into tech start-ups. “India is one of the few markets in the world that offers opportunities to deploy large amounts of private equity,” says Mr Dalmia. Private-equity investment in India this year is expected to reach $1.3 billion, up from $800m in 2003.

China, which has no lack of capital and a tendency quickly to create overcapacity in any successful business, still has many foreign private-equity firms wondering how to make money there. General Atlantic Partners, long one of the savvier and more globally oriented American private-equity firms, has astutely teamed up with AIG, an insurer with great connections in Asia, and particularly in China. “We prefer to find partners in those parts of the world, as we would otherwise spend years trying to understand local conditions,” says Steve Denning, General Atlantic's boss. Having started to invest in China and India three years ago, the firm this year floated one of its Indian firms, Patni Computer Systems, and recently bought a stake in GE's business-process outsourcing unit in India.

Carlyle and Blackstone, with TPG and Bain Capital following close behind, have decided to diversify well beyond private equity. This strategy is not entirely new. Many private-equity firms have long had mezzanine or distressed-debt funds. Blackstone has run a property fund since 1992. One reason for branching out is to provide a “one-stop shop” for limited partners such as big pension funds, which now want to reduce the number of private-equity firms they deal with, but without necessarily making their investments less diverse. Carlyle says it allows investors to pick and move among different market niches, and allocate capital across many funds without being charged the double fee that a fund-of-funds would incur.

Yet as firms concentrate on expanding their assets under management, they may start to care less about performance—which may anyway be affected by the sheer difficulty of evolving from “craft” businesses into huge institutions. And, say, Carlyle's 1-2% annual fees on the $18 billion it manages add up to more than enough to provide its team of 280 investment professionals with a comfortable living even if their results are mediocre—which, to be fair, so far they have not been.

Is there any synergy between different sorts of so-called alternative assets? Blackstone, which tries harder than Carlyle to get its different sorts of fund managers to exchange ideas, says that, for example, during the tech bubble sceptics in its private-equity group saved its property group from investing in office space intended as cheap “telecoms hotels” for internet firms.

Yet even as Blackstone, Carlyle and TPG diversify, private-equity firms are complaining that hedge funds are moving on to their turf. Mr Kravis, noting that in the auction for Texas Genco the KKR club had only narrowly defeated a rival one made up of hedge funds, observed that “hedge funds know how to pick stocks and make a lot of money. But that is not the same thing as creating value through ownership of an asset over the long term in a hands-on way.” Nor do hedge funds have the right valuation skills, say other private-equity bosses. One of them competed unsuccessfully for a stake in Air Canada against Cerberus Capital, a big hedge-fund firm. He reckons that, at $185m, “Cerberus paid three times too much.” Yet Cerberus is the hedge-fund firm most admired, and feared, by private-equity rivals.

Compared with private-equity funds, hedge funds are short-term vehicles from which investors can readily withdraw their capital, usually at least once a year. There is a risk that in the event of a run on them (and private-equity folk all agree that there is now a hedge-fund bubble), hedge funds might have to sell fairly illiquid private-equity investments fast. On the other hand, private-equity firms, with their long-term perspective, have no obvious claim on the short-term trading skills needed to succeed in the hedge-fund business.

But if the buy-out side of private equity faces big challenges, much of the venture-capital business is having an even tougher time, as the next article will show.

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Gut feeling

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Jack Welch on his latest job

"I WAS looking for work," jokes Jack Welch, explaining why he agreed to become a partner at Clayton, Dubilier & Rice (CDR). The much-admired former boss of General Electric surely had no shortage of job offers after he stepped down in 2001. But, he says, "today I see private equity as about as much fun as you can have if you like managing, improving assets, building leadership teams—which is what we do at CDR."

Mr Welch, one of several former bosses of big global public companies to move into private equity, was hired by Don Gogel, CDR's boss, to help get the venerable private-equity firm back on track after a few disappointments, notably an investment in Fairchild Aerospace. Mr Welch's main activity in his part-time role at CDR is to conduct in-depth quarterly reviews of all the firms in the CDR portfolio. He treats each management team to three hours of intense questioning and inspiration—a personal tutorial in the applied management philosophy described in his bestselling autobiography, "Straight from the Gut". The offer of regular meetings with a business legend may also help CDR clinch deals with managers of firms that have a choice of prospective owners. A call from Mr Welch can convince executives to work for, or join the board of, a firm that CDR owns.

Mr Welch used to conduct similar quarterly reviews of the firms within GE's diverse portfolio of businesses, helping to make the firm the exception to the rule that conglomerates underperform. "We do all the same things we did at GE—sit down with the CEO, look him in the eye, go over performance in the past quarter and plans for the next," says Mr Welch. "The only real difference between here and GE is we aim to sell the firm one day."

CDR is probably the most hands-on of the leading private-equity firms in its dealings with the companies it owns. It believes it can still add value, especially with Mr Welch's extra clout. Without the pressure most public companies feel under because they have to publish their results every few months, companies owned by private-equity firms can pursue longer-term strategies, says Mr Welch. CDR combines this long-term perspective with a strong emphasis on corporate governance. "If you don't bring governance, you are not going to be able to make it work." That is why CDR does not take part in club

deals, he says.

Mr Welch's biggest challenge so far? At GE, he wanted to buy only good businesses. At CDR, he has had to “reset my brain to buy broken businesses and fix them”. This has not been easy. “It takes a year to get into the right way of looking at these businesses. Your first reaction is, ‘Jesus. Why would I want to get into that?' ”

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Once burnt, still hopeful

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Has the venture-capital industry learnt its lesson?

THE contrast between the dream and the often disappointing reality of private equity shows up most clearly in the recent history of venture capital. Investors poured their money into the industry, certain that venture capitalists had discovered a corporate alchemist's stone, a quick and reliable way of turning bright ideas into valuable firms. For a while the industry's success seemed to prove them right.

Paul Gompers and Josh Lerner, in their influential 2001 book, “The Money of Invention”, calculate that over the years, “venture capitalists have created nearly one-third of the total market value of all public companies in the United States.” In 1999-2000, more venture capital was raised than in the entire previous life of the industry, stretching back to the 1940s. But when the resulting bubble burst, it wiped out investments of billions of dollars and killed off thousands of young companies, not all of them daft dotcoms.

Even so, the dream lives on, in America at least. Although investment in venture capital is well down from its peak, many experienced venture capitalists think it is still far too high. This means that many investors will probably be disappointed by the returns on their money. And the task of institutionalising and professionalising the erstwhile craft business of venture capital has become much harder.

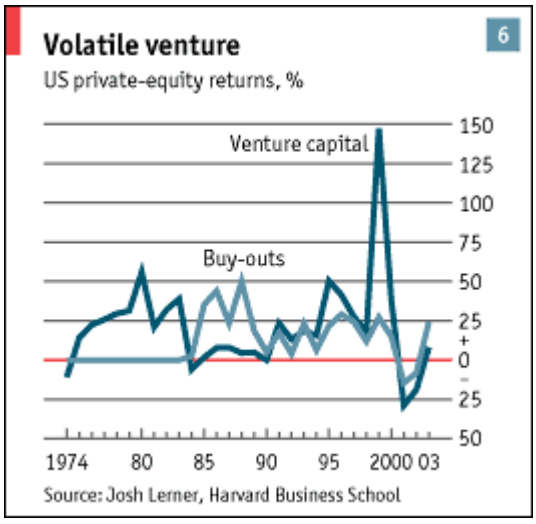
Some of the investors who rushed into venture capital in the late 1990s have rushed out again, dismissed by venture veterans as “tourists and day-trippers”. Most of the big industrial firms that set up venture-capital arms have either pruned them or lopped them off altogether. Many of the wealthy individual “angel” investors who provided seed finance for young firms have, in industry parlance, “gone to heaven”: a lot of them were bubble entrepreneurs who thought they were richer than they proved to be.

Likewise, most buy-out firms have ended the flirtation with venture capital that led some to invest their funds directly in start-ups (as Hicks, Muse, Tate & Furst did, badly, in telecoms) and others to set up venture funds, such as KKR's joint venture with Accel Partners, a leading venture-capital firm. Conversely, the long-term trend for firms that started in venture capital (such as Apax, 3i and Warburg Pincus) to move into buy-outs has reasserted itself.

Even so, venture-capital firms may raise as much as $25 billion this year, compared with only $11 billion in 1997. “The amount of capital raised has come down, but it is still high by historic standards,” says John Jaggers of Sevin Rosen, a long-established venture firm that helped to bring on Compaq, among others. “At this level, the industry as a whole will not make money. It needs to be $10 billion or less to

get decent returns." At $25 billion, he reckons, the industry as a whole may do no more than double its money, rather than more than trebling it, as it would usually hope to do. Given that top-quartile firms usually far outperform the rest, for the average firm an industry-wide doubling of the money invested, spread over the typical ten years, would represent a disappointing annual rate of return.

Certainly the influx of capital has brought much more competition to those parts of the economy that innovate through start-ups. For example, around 50 venture-funded firms are now said to be developing products to improve internet security, compared with the pre-bubble norm of 10-15 firms per sector. Clearly this is a recipe for many more corporate failures—yet many investors appear to have concluded that the bubble period is over, and that venture capital is likely to return to its former profitability.



European chill

European venture capital got going properly only in the late 1990s and was just showing signs of becoming a serious industry when the bubble burst. That stopped it in its tracks. Biotech has been hit especially hard. "The biotech business model is changing here. A lot of VCs are moving away from early-stage investing to later-stage, near-market opportunities," says Sir Chris Evans of Merlin Biosciences, a venture firm that specialises in biotech in Europe. With firms like his now concentrating on investments likely to make money within one or two years, he says, "it is really hard for new, young companies to get early-stage funding in Europe now, and this is having a knock-on effect all the way to the universities, from where innovations usually arise."

Perhaps the bubble in Europe did not last long enough. "It was only really six months, much shorter than in America," says Anne Glover of Amadeus Capital Partners, a British venture-capital firm. This meant that "venture firms in America were able to get a lot more of their firms into the public markets and returned a lot of money to investors. Europe's didn't." That difference may help to explain why confidence in America's venture-capital industry has rebounded, whereas Europe's remain depressed. More broadly, says Mr Lerner, Europe lacks an "entrepreneurial infrastructure"—everything from law firms that specialise in venture to seasoned entrepreneurs and a liquid public market for young firms.

Will European governments try to counter the setback by stimulating domestic venture-capital industries? Some of them have tried before. Between 1965 and 1995, Germany launched over 600 government programmes to encourage venture activity, without obvious success. "The experience worldwide where government has tried to encourage venture capital has not been good," says Colin Blaydon of the Tuck Centre for Private Equity and Entrepreneurship. That is true nowadays even for America's initially useful Small Business Investment Company scheme, introduced nearly half a century ago to provide loans funded by the taxpayer. It became entangled in red tape, but has lingered on.

As new money floods into the industry, a disproportionate amount of it is going to the leading firms. In the buy-out business, well-known firms such as Forstmann Little that went awry have been punished by investors. By contrast, big names in venture capital that performed badly during the bubble period are still able to raise new funds; indeed, some have been turning away would-be investors. The latest funds raised by leading firms have all been smaller than their previous ones, and have been heavily oversubscribed, often two or three times. Kleiner Perkins Caufield & Byers raised $400m, compared with $1 billion last time; Sequoia Capital raised $395m, down from $695m. The only $1 billion venture fund raised lately was by NEA, which does a lot more late-stage investing (and is thus closer to buy-out investing). But that fund, too, was only half the size of the previous one.

After a period when "epiphany replaced rigour", the leading American venture firms are going back to basics, says Scott Meadows, a former venture capitalist who now teaches at the University of Chicago. They are more disciplined in what they will finance, and try to ensure that they can walk away without a huge bill if the venture is not working, he says.

They are also rediscovering how important it is for venture general partners to mentor the entrepreneurs they finance, including taking seats on the boards of firms in their portfolio. The popular bubble-era idea of setting up "incubators" to bring on lots of companies fast and cheaply has been abandoned in favour of

more tried-and-tested venture concepts. The best firms are becoming increasingly careful about what they invest in, and are doing more research before committing themselves. At the same time, some of them have become much more secretive about what they have invested in, in the hope of keeping down the number of imitators.

The top firms are benefiting from a virtuous cycle. Those venture capitalists with the best record of nurturing successful firms tend to attract the best ventures. A lot of entrepreneurs were badly treated after the bubble burst: venture capitalists allocated what money they had left to those firms in their portfolios nearest to achieving an exit, even if others had better long-term prospects. The idea was that if the venture firms returned at least some money to investors, they could quickly get on with raising a new fund. Even the best venture capitalists have upset entrepreneurs with their exit strategy; for example, Google's founders would have preferred to wait longer to do their IPO, but had to rush it because venture capitalists, including Kleiner Perkins, wanted to cash in.

The only serious threat to the growing domination of the leading firms is succession at the top, a problem discussed earlier in this survey. This is arguably even more critical for venture-capital firms than for buy-out firms, because the personality and involvement of the venture capitalist matters far more to a start-up than to a buy-out. Entrepreneurs increasingly want to know which particular partner will work with them before agreeing to a venture firm taking a stake in their business. Yet many leading venture firms, such as Kleiner Perkins and Greylock, have already made a number of successful inter-generational shifts, so the problem may be less pressing than in buy-outs.

Limited partners in venture firms are also becoming increasingly assertive. Kleiner Perkins, for instance, decided to let its limited partners off paying some of the capital they had committed to its worst bubble fund. “Over the next few years, limited partners are likely to be much more rigorous in holding general partners' feet to the fire,” reckons Chicago's Mr Meadows. “They are not any more going to invest in funds where the general partner gets a distribution of cash before 100% of the limited partners' capital has been returned.” During the bubble years, limited partners had to claw back a lot of distributions made to general partners when their funds proved to be less profitable than expected. It is all part of a broader attempt to make private equity more accountable.

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Draw a veil

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The attractions of privacy

OVER the years, big financial institutions have replaced wealthy individuals as the most important category of company owner. With the rise of private equity, they now have two main ways of acquiring their stakes. They can buy shares directly in public stockmarkets, or they can invest in a private-equity fund that will, on their behalf, buy shares in private firms, or in public companies that they then take private. But which model is best?

Institutional investors typically invest well under 10% of their money in private equity, and some still steer clear of it altogether. But to hear people in private equity talk, its superiority over public equities is now overwhelming. Private-equity firms offer the best solution to the biggest problem facing institutional owners: how to ensure that their companies' bosses act in shareholders' best interests. With their hands-on corporate governance—from close but unbureaucratic monitoring at board level to carefully designed incentives for the bosses—they reckon they can deliver a better performance and steer clear of scandals. Corporate governance in the public equity markets remains notoriously weak, despite the increase in activism in the past decade, and particularly since the collapse of Enron in late 2001.

Indeed, the private-equity folk think that recent attempts by politicians and regulators to improve public companies' corporate governance have further strengthened their hand. KKR's Henry Kravis has gone on record as saying that America's Sarbanes-Oxley legislation to tighten up public companies' corporate governance was a “positive development for shareholders. Today directors are taking their responsibilities to shareholders more seriously.” But, he continued, “they are also being more conservative and risk-averse,” and “to the extent that Sarbanes-Oxley causes public companies to be less competitive, there is an opportunity for the private-equity industry in taking these businesses private and putting some energy back into growing them.”

There is no doubt that Sarbanes-Oxley and other legislation and regulation on both sides of the Atlantic have raised the cost of running a public company. Smaller firms, in particular, may feel that an extra $1m a year in compliance costs, say, is enough to tip the cost-benefit analysis in favour of going private. Moreover, argues Larry Harris, who until recently was chief economist at the Securities and Exchange Commission, that is “not a bad thing”. After all, if you take a firm public, “you have a high responsibility to the people who are trusting you with their money.” The most expensive aspect of the Sarbanes-Oxley legislation, he says, is certifying financial results, which requires systems of accountability in public firms: “You need accountability if you are to have publicly distributed capital.”

Mr Harris does not think that there will be any macroeconomic cost if there is a shift away from public to

private equity. “If you can't raise money for a business idea in the private domain, given how much capital there now is in private equity, the idea probably isn't any good.”

Yet it would be premature to celebrate the inevitable triumph of private equity. If most private-equity firms fail to improve their performance, investors may put their money elsewhere. And private-equity firms need healthy public markets as an exit route from their investments. Some leading private-equity bosses even hope to take their own firm public one day. They dislike private equity's long, secretive, inefficient fund-raising process, and the constraints imposed by each fund having a limited lifespan. They admit that the performance of publicly listed private-equity firms (such as Britain's 3i) has often been disappointing, but point to GE and Warren Buffett's Berkshire Hathaway, both of which have permanent capital and profit by doing lots of what are, in essence, private-equity deals.

And even if good exits are available, life is likely to remain tough for private equity as a whole, even as a few big firms and a larger number of niche operators do well. As Mr Kravis has said, many of the techniques that private-equity firms pioneered—paying managers with shares, concentrating on shareholder value, making good use of debt, maximising cashflow—are now standard practice in public firms, making it hard for private equity to outperform public equities. As they grow, private-equity firms may also suffer from diseconomies of scale, becoming more bureaucratic and risk-averse.

So institutional investors should look beyond the hype and question whether private equity really is a better bet than the alternatives. They are surely right to want to make private-equity firms more accountable, because they are not finding it easy to get general partners to accept responsibility when things go wrong. In 2002, the state of Connecticut's pension fund sued Forstmann Little for mismanaging its investment. The pension fund won, but was awarded no damages. It appealed, and Forstmann Little settled out of court for $15m in September this year. Yet this was a pyrrhic victory. In the words of one private-equity veteran, “The only funds that will take Connecticut's money in future will be those that can't raise money from anyone else.” That is quite a penalty in an industry where the best funds far outperform the rest and are able to pick their investors.

A similar punishment was meted out to some public pension funds, notably CalPERS, which last year published the results of the private-equity funds in which they invested. They were only trying to comply with the disclosure requirements of freedom-of-information legislation, but several funds—led by Sequoia, a top venture capitalist—said they would no longer accept money from public pension funds. Some states have since modified their laws to limit the need for such disclosure.

Limited partners are trying to exercise more clout by setting up organisations to represent their collective interests—though the people heading such groups are habitually poached by private-equity firms just as they start to find their voice. Some pension-fund managers responsible for investing in private equity hope to go on to much better-paid jobs in private-equity firms, so may be slow to criticise them for fear of marring their prospects.

Perhaps the growing fund-of-funds industry, led by firms such as HarbourVest and Parthenon, will eventually make a better job of holding general partners to account, not least by encouraging the development of a liquid secondary market in limited partnerships. So far, however, funds-of-funds have stood out mainly for their additional fees.

More accountability will require better information about the performance of private-equity portfolios. As things stand, valuations are a shambles, says Colin Blaydon of the Tuck Centre for Private Equity and Entrepreneurship. Valuation methodologies are not standardised and tend to be overly conservative, using historic cost rather than current market value; and values are rarely reduced when they should be, and are easily manipulated by general partners. But industry groups are slowly making progress with standardising valuation methodology. Herman Daems of the European Private Equity and Venture Capital Association (EVCA) points out that Europe is now well ahead of America on standardising valuations and reporting.

The age of transparency

Government, too, is getting more involved in trying to make private equity more accountable and transparent, either through freedom-of-information legislation or via attempts by watchdogs such as the SEC to regulate the industry. The SEC has hinted that, having started to regulate hedge funds, it may turn to private equity next.

Even with the lobbying expertise of industry groups such as the EVCA, the British Venture Capital Association and America's National Venture Capital Association, it is hard to believe that private equity will be able to escape the growing pressure for institutions of every kind to be transparent. In many respects, greater transparency should improve the performance of private equity by making such firms more accountable to institutional investors—who, in turn, should then be more easily held to account for their investment choices by the public whose money they invest.

Yet transparency can go too far. Private-equity firms may be wrong to oppose attempts to make them disclose the performance of a fund as a whole at frequent intervals. But they are surely right to resist disclosure of the performance of each firm in a fund's portfolio. The one big advantage that private equity still has over public equities is that it can transform firms away from the public gaze and from the short-term pressures of the stockmarkets. Imposing full transparency on the kings of capitalism would destroy this advantage. As Walter Bagehot, a great early editor of *The Economist*, famously observed about the British monarchy, “Its mystery is its life. We must not let in daylight upon magic.”

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The pharmaceuticals industry

From bad to awful

Nov 25th 2004 | LONDON AND NEW YORK
From The Economist print edition

Serious allegations about the behaviour of America's Food and Drug Administration are adding to the mounting woes of big drug firms

HOWEVER intense the pain, the troubles of the world's big pharmaceuticals companies have hardly seemed unusual. Half a dozen other industries in America have also been feeling the lash of energetic state regulators, a hostile business press, political scrutiny and the unwanted attentions of plaintiffs' lawyers. Rumours that Michael Moore plans to make a film about the drug industry (whose employees are under strict instructions to keep their mouths shut) had simply added one more item from what is fast becoming a standard list of business headaches in the new century. Yet, over the past week, the drug firms' crisis has appeared to morph into something uniquely dark and dangerous. Suddenly its American regulator, the Food and Drug Administration (FDA), finds itself under attack. And if public confidence in the regulator goes, worried industry executives and company shareholders are asking, what then?

On November 18th, David Graham, a scientist in the part of the FDA that oversees the safety of medicines after they have been approved, was called to testify before the Senate's powerful finance committee. The committee wanted to know the circumstances behind the sudden withdrawal by Merck in September of Vioxx, a painkiller that, according to some estimates, may have damaged the hearts of more than 100,000 Americans since the FDA approved its use in 1999.

Mr Graham testified that the FDA overvalues the benefits of drugs and “seriously undervalues, disregards and disrespects drug safety”. The FDA has become too chummy with the industry it regulates, hinted Mr Graham. Concerns raised by people such as him that approved drugs might not be safe have met with “denial, rejection and heat”. Mr Graham himself had been pressured to change his conclusions about the risks posed by Vioxx—even as hundreds of Americans were dying every week from side-effects of the drug. America was “virtually defenceless” against another Vioxx, warned Mr Graham, before proceeding to list other looming threats to the nation's health: Crestor (made by AstraZeneca), Serevent (GlaxoSmithKline), Bextra (Pfizer), Meridia (Abbott Laboratories) and Accutane (Roche).

When the drugs don't work

Even as the FDA scrambled to put out its side of the story, Mr Graham's testimony was spreading havoc in the markets. AstraZeneca's share price fell by 10%. Shares in GlaxoSmithKline fell by 6%. Although

Merck's share price hardly budged, traders have already knocked $40 billion off the firm's value in the two months since it withdrew Vioxx. Share prices and valuations continue to collapse across the entire pharmaceuticals industry.

The big drug firms now face several pressing new questions. The first is how the FDA will react to the outbreak of civil war within its ranks. According to much debated analysis by the Tufts Centre for the Study of Drug Development, an independent research group, it takes 10-15 years and, on average, $897m to bring a new drug to market. Under David Kessler, who ran the FDA in the 1990s, the agency took much flack for being too slow and too cautious in the way it approved new drugs, adding costs to the system and denying patients potentially life-saving medicines. More recently, the FDA has tried to streamline things by reducing management (it says that it has trimmed its bureaucracy to only four layers), adopting new scientific techniques to improve the review process and adding a fast-track approval system for important new drugs.

Under fire, the FDA may retreat hastily to its old, risk-averse ways—if, indeed, it ever shed them in the first place. According to the Centre for Medicines Research International, a research group, the time it takes the FDA to approve new drugs has actually risen a bit in the past few years, from one year in 1998 to 1.3 years in 2002. (The FDA remains quicker than Europe, which takes 1.4 years, and Japan, which takes 1.6 years.)

A second question is whether the momentum now building to reform the FDA will carry the day. Mr Graham's call last week to create a new regulator responsible for the safety of approved drugs has since been endorsed by Charles Grassley, who heads the Senate's finance committee, and by an editorial in the *Journal of the American Medical Association* (JAMA). Critics of this proposal argue that a new layer of regulation would encourage even more risk aversion, which would heap more costs and uncertainty on to drug firms. Either way, the FDA's current reliance on the willingness of drug companies to report problems with products that can potentially earn them billions of dollars a year is likely to change. At a minimum, the FDA is likely to get more money and more staff to conduct more of its own research into the safety of the drug industry's products.

Beyond that, America might even borrow from Europe's drug regulator, the European Agency for the Evaluation of Medicinal Products (EMEA). This agency reauthorises (or not) drugs after five years on the market. Such review gives the EMEA the power to enforce drug-industry promises to pursue drug-safety studies after medicines have gone on sale, and an opportunity to take stock of whatever new evidence has emerged about the balance of risk and benefits for any particular drug. In America, drugs firms have completed fewer than half of the post-sales studies they have promised the FDA. Many of these studies, which can be very costly, have not even been started, says *JAMA*.

Perhaps the trickiest question arising from the FDA's woes is what will happen to the industry's soaring (yet unquantifiable) legal and reputational risks. A key part of Merck's defence against the hundreds of lawsuits it faces over Vioxx will be that it kept no information from the FDA, and diligently abided by its regulator's wishes. That defence may carry less clout if Americans come to view the FDA as corrupt and as reckless about the safety of Americans as the drug-firm bosses who feature so regularly in the newspapers and on the evening news these days (see article).

These bosses may find they have the same problem defending themselves as executives accused of fraud in the past few years: what good does it do to plead reliance on the advice of accountants, lawyers and bankers if these supposed checks and balances stand accused of wrongdoing, too? A series of articles published on the JAMA website this week suggested that poor regulatory design had allowed Bayer, a German company, to ignore clear signs that its cholesterol-lowering drug, Baycol, caused potentially catastrophic muscle damage when taken with certain other medicines. Bayer is defending itself against litigation over the drug.

Meanwhile, Mr Graham's testimony may attract further interest from criminal prosecutors at the Department of Justice. Merck has already said that federal prosecutors have subpoenaed it for information relating to the way it researched, marketed and sold Vioxx. Also testifying before Congress last week, Merck's boss, Ray Gilmartin, looked terrified. Will other drug-firm bosses be next?

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Pharmaceuticals

Got a match?

Nov 25th 2004 | PHILADELPHIA
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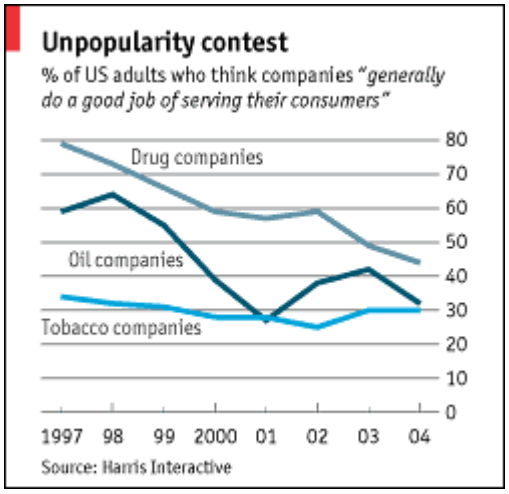
America's unpopular drug giants are offered advice from an unusual source



WHAT do you do when everyone hates you? That is the problem faced by America's pharmaceutical industry. Despite its successes in treating disease and extending longevity, soaring health-care costs and bumper profits mean that big drug firms are widely viewed as exploitative, and regarded almost as unfavourably as tobacco and oil firms (see chart). Last week, at a conference organised by *The Economist* in Philadelphia, the drug industry was offered some advice from an unlikely source: a tobacco firm. Steven Parrish of Altria, the conglomerate that includes Philip Morris, gave his perspective on how an industry can improve its tarnished public image.

Comparing the tobacco and pharmaceutical industries might seem absurd, or even offensive. “Their products kill people. Our products save people's lives,” says Alan Holmer, the head of the Pharmaceutical Research and Manufacturers of America, an industry association. Yet the drug giants currently face an unprecedented onslaught of class-action lawsuits and public scrutiny; industry bosses are being grilled by lawmakers asking who knew what and when. It is all reminiscent of what happened to the tobacco industry in 1994.

Mr Parrish advised drug firms to abandon their bunker mentality and engage with their critics. Rather than arguing about the past, he said, it is better to move on, and give people something new to think about. (Philip Morris now acknowledges, for example, that cigarettes are addictive and deadly, and is trying to develop less harmful products.) Not everyone is open to persuasion, so focus on those who are, he said. But changing opinions takes time and demands deeds as well as words: “This is not about spin, this is about change.”

The pharmaceutical industry is pursuing a range of initiatives to mollify its critics, Mr Holmer noted in his own speech. But Mr Parrish suggested that speaking with one voice through a trade association might be counter-productive, since it can give the impression that the industry is a monolithic cartel. And too much advertising, he said, can actually antagonise people further.

The audience was generally receptive, claims Mr Parrish. This is not the first time he has offered his thoughts on dealing with implacable critics. At a conference at the University of Michigan last year, he offered America's State Department advice on improving America's image in the Middle East. So does his prescription work? There has been a positive shift in attitudes towards tobacco firms, if only a small one. But at least, for once, a tobacco firm is peddling a cure, rather than a disease.

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McDonald's

Fast-food succession

Nov 25th 2004
From The Economist print edition

Another change at the top

Get article background

CHARLIE BELL became chief executive of McDonald's in April. Within a month doctors told him that he had colorectal cancer. After stockmarket hours on November 22nd, the fast-food firm said he had resigned; it would need a third bossin under a year. Yet when the market opened, its share price barely dipped then edged higher. After all, McDonald's had, again, shown how to act swiftly and decisively in appointing a new boss.

Mr Bell himself got the top job when Jim Cantalupo died of a heart attack hours before he was due to address a convention of McDonald's franchisees. Mr Cantalupo was a McDonald's veteran brought out of retirement in January 2003 to help remodel the firm after sales began falling because of dirty restaurants, indifferent service and growing concern about junk food. He devised a recovery plan, backed by massive marketing, and promoted Mr Bell to chief operating officer. When Mr Cantalupo died, a rapidly convened board confirmed Mr Bell, a 44-year-old Australian already widely seen as his heir apparent, in the top job. The convention got its promised chief executive's address, from the firm's first non-American leader.

Yet within weeks executives had to think about what to do if Mr Bell became too ill to continue. Perhaps Mr Bell had the same thing on his mind: he usually introduced Jim Skinner, the 60-year-old vice-chairman, to visitors as the “steady hand at the wheel”. Now Mr Skinner, an expert on the firm's overseas operations, becomes chief executive, and Mike Roberts, head of its American operations, joins the board as chief operating officer.

Is Mr Roberts now the new heir apparent? Maybe. McDonald's has brought in supposedly healthier choices such as salads and toasted sandwiches worldwide and, instead of relying for most of its growth on opening new restaurants, has turned to upgrading its 31,000 existing ones. America has done best at this; under Mr Roberts, like-for-like sales there were up by 7.5% in October on a year earlier.

The new team's task is to keep the revitalisation plan on course, especially overseas, where some American brands are said to face political hostility from consumers. This is a big challenge. Is an in-house succession the best way to tackle it? Mr Skinner and Mr Roberts are both company veterans, having joined in the 1970s. Some recent academic studies find that the planned succession of a new boss groomed from within, such as Mr Bell and now (arguably) Mr Roberts, produces better results than looking hastily, or outside, for one. McDonald's smooth handling of its serial misfortunes at the top certainly seems to prove the point. Even so, everyone at McDonald's must be hoping that it will be a long time before the firm faces yet another such emergency.

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French newspapers

A licence to lose money

Nov 25th 2004 | PARIS
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The French press is in bad shape

AFTER a recent crisis at *Le Figaro*, France's leading centre-right paper, it is now the turn of *Le Monde*, France's leading centre-left paper. Last week the paper started to lay off 90 staff. On November 22nd shareholders held an emergency meeting to discuss its precarious finances. On November 24th Parisian papers reported rumours of the imminent sacking of Edwy Plenel, *Le Monde*'s executive director.

The crisis at *Le Monde* started last year when two journalists published "The Hidden Face of *Le Monde*", a scathing attack on the integrity of Jean-Marie Colombani, the paper's editor-in-chief (obsessed with his native Corsica) and Mr Plenel. Its reputation as the conscience of the nation, nurtured over six decades among the Loden-coated intellectual classes, never recovered. Now it is bleeding money: it is almost €150m ($195m) in the red, and likely to lose €35m this year. To make ends meet, *Le Monde* is selling property and other assets while it contemplates switching publication from afternoon to morning.

Nearly all French newspapers are in dire straits. After losing €550,000 last year, *Libération*, a left-wing daily, may lose more than €2m this year. It is talking to Vincent Bolloré, an investor in media and advertising, who is interested in buying a stake. The usually profitable *Le Figaro* may make a loss this year. *Le Parisien-Aujourd'hui*, a tabloid, has lost €50m in the past three years and is cutting jobs; its boss may be for the chop, too. *France-Soir*, another tabloid, is on the verge of bankruptcy, as is *L'Humanité*, the Communist Party's mouthpiece. Only two business dailies, *Les Echos*, owned by Pearson (part-owner of *The Economist*), and *La Tribune*, owned by LVMH, a luxury-goods conglomerate; *L'Equipe*, a sports paper; and *La Croix*, a Catholic daily, make profits.

Newspapers are not big business in a country where many prefer magazines and television. Circulation is tiny. *Le Monde* and *Le Figaro* sell only 380,000 and 350,000 respectively, compared with the 900,000 claimed by the *Daily Telegraph*, Britain's biggest broadsheet, and the 430,000 of the *Süddeutsche Zeitung*, one of Germany's national broadsheets.

Though newspapers are in trouble in many countries because of the decline in advertising income, there are some features specific to the French crisis. The Nouvelles Messageries de la Presse Parisienne, France' s news-stand distributor, is an inefficient monopolist. Unions wield considerable power. Papers typically cost more—though two new free papers, *Métro* and *20 Minutes*, are a hit, with a circulation of 500,000 and 750,000 respectively.

This being France, the government is responding to the crisis with more subsidies and an official report. The French press benefits from various direct and indirect handouts. Some regional papers get up to 15% of their revenue from the government. The national post office delivers papers at a loss and journalists enjoy hugely generous tax breaks (scandalously denied to their counterparts abroad). Next year the government plans to spend €278m on newspaper subsidies. Last month Bernard Spitz, a government official, produced a report for the minister of culture recommending giving free two-month newspaper subscriptions to those who turn 18 next year. They can choose any paper they fancy—except (spoil-sports) for *L'Equipe*.

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Satellite radio

King of all media?

Nov 25th 2004
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Satellite radio's growth potential is wowing the stockmarket

AP

Satellite of lust

EXECUTIVES at America's giant media firms may have envied Mel Karmazin, formerly chief operating officer of Viacom, as he joined an upstart satellite-radio outfit called Sirius last week. “I wanted to be CEO of a company that was a growth company,” he declared, adding that this meant no big media firms. The much-admired Mr Karmazin had his pick of jobs. But faced with the prospect of managing, say, Disney's mature theme parks or another firm's slow-growth old media businesses, Mr Karmazin thought that joining satellite radio's “revolution” would be more fun.

His choice looked especially astute this week as Viacom agreed to pay its regulator, the Federal Communications Commission (FCC), a record $3.5m as a punishment for airing indecent material. Much of the fine is due to the sexual hilarity of Howard Stern, an old friend of Mr Karmazin who now broadcasts on Viacom's Infinity Radio. Mr Stern said in October that he will leave conventional radio to join Sirius in 2006. So Mr Karmazin and Mr Stern will soon be reunited, safe beyond the reach of the regulator. Because people have to pay for satellite radio, it can air what it likes.

Many investors think that Mr Karmazin's arrival at Sirius is the endorsement that satellite radio needed to become a mainstream media category, not just a successful niche. Sirius's shares rose by one-third on news of his appointment. Its announcement this week that subscribers had jumped from 662,289 at the end of September to over 800,000 today helped. Its main rival, XM Satellite Radio, had 2.5m subscribers at the end of September.

Expectations are now sky-high for the two companies. Will satellite radio grow at the expense of terrestrial radio in the same way that cable and satellite television have won viewers from the broadcast networks? Sirius and XM Radio have a combined market value of roughly $15 billion. But they together made a loss of $900m or so last year, and are not expected to break even until 2007-09. The five largest pure terrestrial radio firms, by comparison, made profits of around $200m yet have a combined market capitalisation of $8 billion. It may be a terrific product, says Lawrence Haverty, a managing director at State Street Research in Boston, but the value that investors are putting on Sirius and XM Radio is hard to justify.

Sirius expects to have 1m customers by the end of 2004. XM Radio says it will have 20m by 2010. Satellite radio offers music free of advertisements, dozens of speciality channels, high quality sound and

continuous, national coverage. Sirius's service costs $12.95 a month and XM Radio's $9.99. Listeners also need to spend $100 for a receiver. Terrestrial radio is free, but is cluttered with adverts and offers less variety.

Sirius is betting that much of Mr Stern's loyal fan base of about 10m-12m listeners will shift to satellite radio once they can no longer hear him on Infinity. Mr Stern is agitating to be free of his contract with Viacom sooner than 2006, which would give another boost to the share price. Carmakers are rooting for satellite radio, too. General Motors, Ford, DaimlerChrysler, Honda and others are each building the devices into new cars. Dealers increasingly offer discounted satellite-radio packages.

Messrs Karmazin and Stern have joined the smaller and more erratic of the two satellite-radio firms. Sirius was willing to pay more than XM Radio to get Mr Stern and his team—$100m a year for five years—and Mr Karmazin followed him. For now Sirius has the momentum. But there is room for both services to grow, especially if the FCC keeps trying to scrub clean America's public airwaves. As Mr Stern put it at a rally in New York last week, “Once you start listening, it's like crack. You will be addicted.”

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Yukos, Putin and the oligarchs

The bell tolls

Nov 25th 2004 | MOSCOW
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The much-anticipated demise of Yukos is now imminent

UNTIL last week, the Russian government's campaign against Yukos had resembled a form of water torture. Now the Kremlin seems to have decided that a quick, violent end would be preferable to a slow death, and has set a date for what may be the oil firm's execution.

Russia's federal property fund has announced that the entire voting stock of Yuganskneftegaz, Yukos's main oil-production subsidiary, will be forcibly sold at auction on December 19th. Yukos will then cease to be the energy giant it was before Mikhail Khodorkovsky, its founder, upset President Vladimir Putin, landing himself in jail and his firm with debts to the government in back taxes and penalties (now) of around $21 billion (some $4 billion having been paid).

Will anything remain of Yukos after this dismemberment, and with it any residual value for minority investors? Maybe—there are rumours of a last minute deal between Mr Khodorkovsky and the government—but probably not. Who will buy? Even with Yugansk's coveted reserves, given its recent past only a buyer with close connections to the government is likely to take the risk. One candidate is state-run Gazprom, perhaps in conjunction with a more cash-rich partner. The starting price of $8.7 billion is higher than anticipated. Perhaps nobody will buy Yugansk, and the government will keep it.

The other big question is who, if anyone, is next? Just before the Yugansk announcement, TNK-BP, an Anglo-Russian oil firm, received a small back-tax bill. Rumours began to circulate about a bigger (though not ruinous) bill soon to be sent to Sibneft, an oil firm controlled by soccer-loving Roman Abramovich. These are probably merely efforts to make the Yukos affair seem part of an equitable policy, rather than a personal vendetta, as a way of drawing a line under the sorry, destructive saga. Probably.

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China's business links with Africa

A new scramble

Nov 25th 2004 | JOHANNESBURG
From The Economist print edition

Booming Chinese interest in Africa is not just about oil

TRADE with Asia is up, its investors flock to Africa's oil wells, its businessmen agree cosy ties with African ministers. For Asia, read, above all, China. Local analysts of African business are in a frenzy about the new wind from the East. At a recent oil and gas conference in Cape Town, speakers lined up to describe the rush. One produced a map of Africa, highlighting new Asian oil interests: it was a forest of Chinese flags.

Asia now takes about 13% of African exports. A China-Africa Business Council formed this month in Beijing reckons that two-way trade was some $18 billion last year, a nine-fold increase on 1999. Chinese officials expect it to grow to $30 billion within two years.

Chinese investment in Africa still lags that from America and Britain. But a recent World Bank study records its “astonishing” growth in the four years to 2002. More is on the way. “Within five years, China could be one of the top three investors on the continent,” says Iraj Abedian, an independent economist.

Oil is currently the big draw. Unlike their increasingly publicity-sensitive western rivals, the Chinese have no qualms about making deals with oil-rich dictators, however corrupt or nasty. State-owned China National Petroleum Corporation, eager for secure long-term supplies, has bought 40% of a large project in Sudan. Chinese workers recently built a 1,600km pipeline there, in just 11 months.

Chinese firms—as well as Indian ones—moved into Sudan after American investors left (the United States applies sanctions to Sudan, which it now accuses of genocide). Other westerners also hold back, fearing the bad publicity that forced Talisman, a Canadian oil firm, to quit a few years ago. But a Chinese trade spokesman said of Sudan in September, “We import from every source we can get oil from.”

It is a similar story elsewhere. Western oil firms fear that deals with famously venal rulers, as in Angola, will come under ever-closer scrutiny: for example, under an “extractive industries initiative” pushed by Britain last year to encourage more openness. Firms from China face no such restraints. In March its government dished out a $2 billion soft loan to Angola, in exchange for 10,000 barrels a day of oil. Over the past year some very senior Chinese politicians have toured other oil-rich countries, such as Gabon and Nigeria, cooking up similarly close ties. Peter Draper, a trade expert at the South African Institute of International Affairs, calls it China's “ethical advantage” over rivals.

Oil is not alone. Chinese firms reportedly have spent some $100m in the past two years in Zambia's once-decrepit copper industry. South Africa's exports to China have more than doubled in five years, and increasingly they are raw materials such as coal and gold, not manufactures. Minerals probably drive China's friendship with Zimbabwe. A $200m deal to supply fighter jets and other military goods was reported earlier this year. Zimbabwe also promotes tourism from China and twice-weekly direct flights from its capital, Harare, to Beijing, are about to take off. Several state contracts were struck recently with Chinese firms. Much of Zimbabwe's shrinking tobacco crop is now sold to China. If western mining companies are eventually squeezed out, the Chinese will be well placed to move in.

China has now struck trade deals with 40 African countries—many without mineral riches. Construction and telecoms deals are widespread: Huawei, a Chinese telecoms firm, said last week that it had won contracts worth $400m to service mobile-phone networks in Kenya, Zimbabwe and Nigeria. Chinese contractors are said to be ready to work on a $600m hydroelectric plant at Kafue Gorge, in southern Zambia. Chinese agricultural firms tend land in Zambia too. Others are active in hotel, road and other big construction, notably in Botswana and South Africa.

Chinese firms use factories in Africa to stitch garments that can go duty-free into the United States. And Africa's imports of Chinese manufactures are rising fast. South Africa's trade unions recently complained that domestic industry was being flattened by cheap imports of hi-tech goods, computers, telecoms equipment and the like. China's interest in Africa goes beyond grabbing supplies of black gold; it will be sustained for a long time yet.

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Reliance Industries

Primogeniture rules, OK?

Nov 25th 2004 | DELHI
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Two brothers fight over the family firm—$17 billion-worth of it

Reuters

Cherchez la femme?

INDIA has few large private firms for the same reason that it has few large private farms: traditions of inheritance that divide assets rather than giving them to the first-born. Still, most family firms survive until the third generation before splitting. Reliance may prove an exception. A bitter dispute between the founder's two sons may lead to a reorganisation of India's biggest private-sector group, whose interests include oil and gas, the world's largest polyester maker and India's biggest mobile-telephony firm.

Sibling rivalry at Reliance has been rumoured ever since its founder, Dhirubhai Ambani, died in 2002. In little more than two decades he had built it into a giant business. His two sons, Mukesh and Anil, bickered even before his death. After he died they fell out so badly that they have not met in private for more than a year.

The row surfaced in August when the *Times of India* spoke of “deep turmoil” between the two. This month, the elder brother, 47-year-old Mukesh, chairman and managing director of Reliance Industries, the group's flagship, admitted there were “ownership issues”. He later said his remarks had been “torn out of context” and e-mailed all 80,000 Reliance employees, saying his father had left no ambiguity, and that he, Mukesh, was the “final authority on matters concerning Reliance”.

This did little to reassure Reliance's millions of small investors. Friends of Anil, the younger brother, are spreading his version of events, disputing Mukesh's claim to most of the family shareholding. They accuse Mukesh of wanting to oust Anil, who was raising questions about the money Reliance Industries is pouring into Mukesh's pet project, Reliance Infocomm, the mobile-phone arm. If need be, they say, Anil will fight in the courts.

There is plenty to fight about. The market values Reliance Industries at about $17 billion. The family controls 46% of the shares, 12.6% through an investment trust, the rest through hundreds of companies whose ownership is obscure. Reliance Industries in turn has big stakes in Infocomm and Reliance Energy, a listed company run by Anil, which is India's biggest private-sector power utility. On November 25th six directors resigned from the board of Reliance Energy, denting its share price. This was seen as a move to undermine Anil, and suggested that the battle will cover the whole group. Dhirubhai Ambani did not leave a will. So, under Indian law, his holdings would be divided among family members.

What caused the rift between the brothers is hotly debated. The *Times of India* blamed their wives' mutual antipathy. Mukesh is cerebral and introverted. Anil runs marathons and consorts with the glitterati. In July, he joined India's upper house of parliament as a nominated member. Are his political activities the trouble? No, say his supporters. They blame the ambitions of Mukesh's wife, and his

determination to secure the succession for her and for their children.

Both brothers have bragged of their companies' professionalism and ability to compete internationally—a rebuff to critics who accuse Reliance of thriving through political influence rather than sheer commercial merit. But a lengthy legal wrangle could make a mockery of these claims.

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Face value

Foundation and empire

Nov 25th 2004
From The Economist print edition

Landov

Vodafone's strategy, and Arun Sarin's leadership, are being put to the test by 3G

THE era of empire building, it was generally argued when Arun Sarin became Vodafone's chief executive in July 2003, was over. What was needed instead was a manager capable of integrating the global collection of mobile-phone operators assembled by Chris Gent, Mr Sarin's swashbuckling predecessor, as he built Vodafone into the world's largest mobile operator. Sir Chris collected the pieces: Mr Sarin's mission was to fit them together to achieve economies of scale and so to justify Vodafone's bigger-is-better strategy. For the past 15 months, Mr Sarin has been doing just that, though mostly behind the scenes. Only now is the curtain finally being raised, with the launch this month of “third-generation” (3G) mobile services in 12 European countries and a relaunch in Japan. The roll-out of 3G, Mr Sarin agrees, will provide litmus tests of both his own leadership and Vodafone's ability to function as a unified entity.

Redrawing organisation charts, rationalising back-room systems and cutting costs are hardly the sorts of activities that generate headlines, so Vodafone seems a less dynamic firm than it was under Sir Chris. But this dull-but-necessary work is what Mr Sarin is good at, and what Vodafone needs to bring its sprawling divisions together. His “One Vodafone” project has sorted out the behind-the-scenes spaghetti at Vodafone's national affiliates, so that they are now all using the same technology. This cuts costs by making it possible to develop a new service once, and then introduce it in many markets simultaneously.

Grand unification theory

Mr Sarin has also restructured Vodafone's management. The bosses of its large regional operations now report directly to him. The head of marketing at each national operator now reports to the group head of marketing, rather than simply to his local boss, and so on. The aim is to bind the national operators together and give Mr Sarin more direct control of his firm. Aligning structure with strategy in this way will, he hopes, enable the firm to “execute flawlessly”.

This is not rocket science. But these moves are characteristic of Mr Sarin. Jovial and pragmatic, he prefers simple explanations to torrents of jargon, and is equally at home with both cricket and baseball analogies, as you might expect from someone born and brought up in India, and now an American citizen. Simplifying Vodafone's structure, he believes, is the foundation for making 3G a success, for it enables Vodafone to reap the benefits of its global scale. A single technology platform allows it to test handsets or services in one market and then deploy them everywhere. It ensures seamless international

roaming, even for video calling. And it has allowed Vodafone to use its Japanese operation as a test-bed for 3G.

By far the greatest benefit of Vodafone's scale is its resulting clout with handset-makers. It has set strict standards for its 3G handsets, and even the biggest handset-makers have no choice but to comply with them if they want Vodafone's business. Using the same technology in both Japan and Europe means that Vodafone can offer Japanese handset-makers access to European markets and western firms access to the Japanese market, while playing them off against each other.

The launch of 3G services in 13 countries this month, with a common range of handsets and an impressive list of content partners is, then, the result of months of reorganisation, testing, bug-fixing and negotiation. “We've been through highs and lows,” says Mr Sarin. But he believes the company is both stronger and more flexible as a result: “We've been tempered, like steel.” He hopes to sign up 10m 3G users by March 2006. It is not hard to see why Mr Sarin is optimistic. The firm's latest financial results, released last week, showed steady, solid improvement. The firm also sent a further signal that the empire-building era is over, announcing a doubling of its dividend and an expanded share-buyback plan—returning cash to investors rather than hoarding it for big acquisitions.

There is, however, a fly in the ointment: America. Vodafone owns only a non-controlling 45% of its American affiliate, Verizon Wireless, a joint-venture with Verizon. That is why Mr Sarin made a bid for AT&T Wireless, another American operator, last February: it would have enabled him to launch Vodafone's brand in America and align its American arm with its operations elsewhere (since Verizon uses a different wireless standard). But he was outbid by Cingular, another American operator, which recently completed the $41 billion acquisition.

Arguably, Mr Sarin's failure to win AT&T Wireless was a blessing in disguise. Vodafone has been able to focus on launching 3G without being distracted by a big acquisition: AT&T Wireless's network is a patchwork of different technologies that Cingular is likely to take two years to sort out. Verizon Wireless is well placed to profit from the confusion, says Mr Sarin, who is happy to play a waiting game. The technological difference between the Verizon Wireless network and those of Vodafone's other affiliates “will matter less in time”. Already, Vodafone offers a dual-mode handset to customers who wish to roam between its American and European networks. Ultimately, he hopes that Verizon's shareholders will see the logic of separating its wireline and wireless operations, which would make it easier for him to win control of Verizon Wireless.

The unpleasant alternative would be to mount a hostile takeover of Verizon—the sort of thing that Sir Chris might have relished, but out of keeping with Mr Sarin's more measured style. For now, he is concentrating on getting 3G off the ground. But sooner or later Mr Sarin will have to address his firm's weakness in America. Even if the 3G roll-out goes as planned and validates Mr Sarin's reputation for operational expertise, some swashbuckling may yet be required.

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The software-development industry

Managing complexity

Nov 25th 2004
From The Economist print edition

Most software projects fail to meet their goals. Can this be fixed by giving developers better tools?

ON SEPTEMBER 14th, the radios in an air-traffic control centre in Palmdale, California shut down, grounding hundreds of flights in southern California and Nevada, and leading to five mid-air encounters between aircraft unable to talk to the ground controllers. Disaster was averted because aircraft managed to communicate with more distant back-up facilities. But why did Palmdale's radios fail? A glitch in the software running the system meant the computers had to be re-booted every 30 days, and somebody forgot to do so. But software running a mission-critical system should not have to be restarted every month. The culprit: poor design.

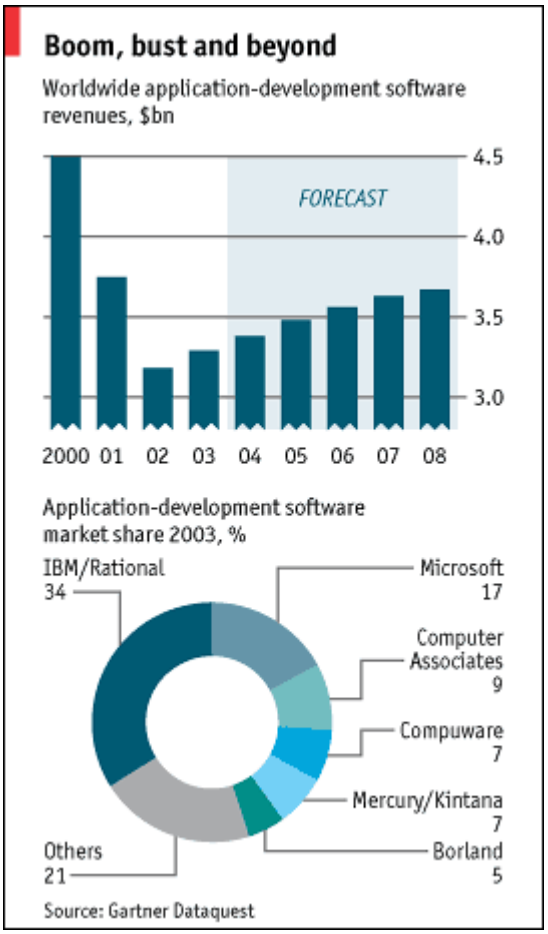
At least Palmdale's software worked some of the time. The same cannot be said of an $4 billion write-off that America's Internal Revenue Service (IRS) had to swallow when a multi-year effort to overhaul its computer system failed completely in 1997. And such problems are confined neither to governments nor to America. A £456m ($844m) project for Britain's Child Support Agency came in over a year late, and has failed to deliver payments to more than half of eligible applicants.

As software has become more and more pervasive in business and government, and more complicated, the impact of poor software design has been steadily growing. A study earlier this year by the Standish Group, a technology consultancy, estimated that 30% of all software projects are cancelled, nearly half come in over budget, 60% are considered failures by the organisations that initiated them, and nine out of ten come in late. A 2002 study by America's National Institute of Standards (NIST), a government research body, found that software errors cost the American economy $59.5 billion annually. Worldwide, it would be safe to multiply this figure by a factor of two. So who is to blame for such systematic incompetence?

Cost overruns and delays are common in numerous industries—few large infrastructure projects, for instance, are completed either on time or on budget. But it is peculiar to software that billions of dollars can be spent only for nothing useful to result. At a very basic level, it is the fault of the software engineers who are writing the programs, and of their bosses. Even companies that specialise in software development suffer from delays and overruns. An obvious example is Microsoft: its “Longhorn”, the long-heralded successor to its Windows XP operating system, was originally scheduled for launch this year. Longhorn is now not expected before mid-2006, and many of its key features have been put off until 2007.

The prevalence of such failures can be explained by one startling weakness: the tools available to software developers. As software projects have become more and more complicated, it has become impossible for even the most talented team of programmers to keep track of the millions of lines of "code" required. As long ago as the 1980s the industry began to rely heavily on software-development applications—basically, software that helps write software, for example by creating reusable modules that form part of broader processes. The problem is that these have simply not been up to the task. As a report in May by Forrester Research, another consultancy, succinctly put it: "Corporate software development is broken."

Dale Fuller, the boss of Borland, a software-development company, agrees. He also thinks he can fix the problem of weak tools. So does John Swainson, long in charge of software development at IBM and now bound for the top job at Computer Associates. John Montgomery, who runs such things for Microsoft, does not think the situation is quite so bad. However, he believes Microsoft has what it takes to "commoditise common problems" and so enable average software developers to write above-average programs. And a bevy of smaller companies offers solutions as well. The challenge facing all of these companies is how to create tools that are reliable, yet capable of dealing with millions of lines of code and requirements that can shift, sometimes alarmingly, during a project's lifetime.



The importance of the software-development sector to business as a whole is huge. It is also an increasingly substantial business in itself (see chart). And, as Mr Montgomery points out, although selling software-development applications is profitable for Microsoft, it is also a way of winning new business. Better development tools mean more software is written for Windows, which in turn means more people are likely to use the operating system. Ditto for rivals—one reason IBM is making a big push to support development in various flavours of Unix (including in the "open source" version—ie, software code that is non-proprietary and ostensibly free to anyone—Linux). Unix is a long-established operating system that remains the biggest threat to Windows.

Three main trends are shaping the future of software development and giving hope to those who oversee big software projects. The first is awareness of the need to pay greater attention to the lifecycle of a piece of software, from the initial setting of requirements to ongoing implementation. The second trend is towards automating the testing of software. The NIST study estimates that $22.2 billion (more than one-third) of the cost of software failures could be eliminated simply by improved testing. The third trend is the emergence of open-source code, something embraced even by Microsoft, which is often seen by its many critics as the would-be nemesis of the open-source movement.

The five-step program

There are five steps involved in creating a piece of software: enumerating the requirements; designing the program; actually writing the code; testing it; and then deploying it. Traditionally and naturally enough, this was seen as a sequential process. However, Mr Swainson points out that by the time an organisation gets around to deploying a piece of software, its requirements have often already changed. This, he says, means that an "iterative" model, in which an organisation continually cycles through the five phases, makes more sense than the traditional "waterfall" which puts them in sequence.

Although the consensus among software-development providers is that iterative models are the way forward, a note of caution is in order. A paper by Phillip Laplante and Colin Neill of Penn State University in the February issue of *ACM Queue*, a scholarly journal, claims that, in practice, the waterfall remains by far the most popular model. It may be that real change is lagging behind developers' marketing literature, or that the iterative approach is more style than substance.

Borland, though, is betting its business on the success of the iterative model. In September it announced “Software Delivery Optimisation”, an approach that seeks to bring together all five bits of the development cycle, along with the people who are constantly making decisions about the project. At the heart of the system is management software called Themis (the Greek goddess of order), planned for release in the first half of 2005. Themis will have a module that turns models automatically into programming code. When code is written, it will instantly update the requirements input by the business developers. Mr Fuller says that this will transcend even the iterative model because the iteration will be so fast as to be seamless. As soon as a portion of the code is completed, it will be tested. As soon as requirements change, programmers will instantly change course.

If that sounds a bit utopian, it is by no means unique. In October, IBM announced its newest package, called “Atlantic”, which is poised to compete with Themis. Atlantic is based both around IBM's own products and those of Rational, a company bought by IBM in December 2002 for $2.1 billion. Not to be left out, Microsoft will release a similar product called Visual Studio 2005 sometime in the first half of next year. The rhetoric of this rush of entrants into the marketplace is almost indistinguishable.

This is partially due to the fact that, although they are competitors, and fierce ones at that, they are also collaborators. Mr Montgomery points out several bits of development software—WS-Routing, for instance (which handles network routing) and WS-Security (you guessed it, security)—that were developed jointly by IBM and Microsoft. Both firms trumpet that their development software is used by an impressive percentage of the world's largest companies, and both support the same basic standards, such as XML (a language for exchanging data on the web) and other web protocols.

Indeed, so-called web services—programs that are meant to run on the web and be accessed by many computers remotely—are the primary battleground for the next generation of software-development applications. The business case rests on the view that almost anything can be done over the web. This is particularly true for the most common, commodity-type applications where most of the available revenues appear to be.

Tick this box

One snag is that, so far, web services have turned out to be much harder to deliver than their champions had hoped. Consider the example of a relatively simple challenge: enrolling 6m Americans living abroad who wanted to use the internet to cast their votes in the recent elections. America's Defence Department, which has responsibility for helping expats to vote, decided to launch a pilot program for 100,000 people, and even came up with an acronym: SERVE, or Secure Electronic Registration and Voting Experiment. In February, after $22m had already been spent, the project was abandoned. The software was judged to be too unreliable.

The various efforts to prevent the occurrence of such disasters—IBM's web-services platform is called WebSphere, and Microsoft's suite of development tools for web services is known as .NET—have more similarities than differences. IBM tends to favour Java as its native programming language, while Microsoft prefers C#, a language it developed itself. However, both firms' platforms support other languages. Borland claims that, being neutral, it does a better job, but marketing seems to be as important as technology when it comes to winning market share.

That is why Mr Montgomery emphasises Microsoft's efforts to create an “ecosystem” of developers. He says that the company has spent, over the years, hundreds of millions, if not billions, of dollars investing in the Microsoft Developer Network. This is certainly a busy website—some 3m developers a month visit to exchange programs and ideas, Mr Montgomery says. Indeed, some of the developers come up with products that compete directly with elements of .NET.

What's more, Mr Montgomery says that the tools made by companies such as Component 1 and Infragistics are better than Microsoft's own, and that this is something Microsoft encourages. The small fry make millions of dollars by staying one step ahead of Microsoft, but the giant benefits because its overall ecosystem is strengthened.

If software development in general is somewhat fragmented, in the area of software testing there is one clear market leader: Mercury Interactive, a company based in Mountain View, California. Other companies, especially IBM, are trying to make inroads into testing, and Mercury itself is trying to expand into other areas, particularly through an initiative called “Business Technology Optimisation” (yes, the initiatives all start to sound rather similar). That aims to do the kind of system-level integration at which

companies such as Borland have traditionally been best. However, industry watchers say there is real promise in efforts to refine the testing process.

There are two sorts of software testing. The first, unit testing, tests a very small subroutine to see that it does what it should. The second, functional testing, is actually trying to use the software. Unit testing is far more straightforward—it is easier to test if a brick will crumble than if an entire structure is sound. Functional testing, on the other hand, is tricky—how is one to know if the software is fully tested? However, according to Mercury, about 60% of the necessary functional testing can be automated—things like repeatedly entering data. And automation allows the developers to explore a far larger number of test cases than would be possible by hand, in far less time. The gains are even greater when software is revised—old automated tests can often be re-used, whereas manual testers would have to start from scratch.

The benefits of this approach are amplified by the transition to the iterative approach—testing is much more effective if its results can be easily re-integrated into the software. Indeed, there is a symbiosis here: the faster testing made possible by automation is easing the transition from the waterfall model to an iterative one. Hence the interest from IBM and Microsoft.

An open-source solution?

The third big industry trend is arguably the most promising of them all. As Mr Montgomery points out, there are two ways of thinking about open-source software development. The first is to see it as a business model, and the second is to understand it as a development process. Microsoft, he says, makes a large amount of source code available under a so-called shared-source licence, which grants users downstream a limited set of rights to modify and use the code.

For purists, this is not enough. However, Mr Montgomery says it suffices to build the sort of community Microsoft wants, while retaining its ability to make a profit. (For instance, people are allowed to take the code, modify it and sell it, but only if it will be used on a Microsoft operating system.) IBM uses a similarly restrictive licence, but it has built its platform on top of Eclipse, a purer open-source framework for building integrated development environments.

However, other companies, such as CollabNet, a firm based in Brisbane, California, are using a less restrictive licence, along the lines of what is traditionally thought of as open source, with only one exception—the licence allows for commercial use. Brian Behlendorf, founder and chief technology officer of CollabNet, says that the open-source ethos allows programmers, particularly those collaborating from different locations, to work together more efficiently. He contends that the freedom to tinker with and improve tools essentially without restriction is the best route to efficiency. Mr Behlendorf was a pioneer in the development of the well-known Apache open-source web server, so his views come as little surprise. Less predictably, they are shared by businesses not usually thought of as being open-source enthusiasts.

For instance, CollabNet signed a deal earlier this month with Barclays Global Investors (BGI), a large asset manager, to provide it with development tools for the next three years. Mr Behlendorf points out that software-development companies, like software companies themselves, are moving towards a model of selling services rather than products. The tools that CollabNet uses are almost all open-source, but by paying “rent”, clients get the benefits of the company's expertise. It seems to work. BGI reports that since it first started using CollabNet two years ago, the time it takes to complete a project has halved.

The three big industry trends—lifecycle management, testing and open source—come together in a movement known as “agile” programming. This approach to software development was codified in a meeting in February 2001 in Utah when a group of programmers declared its allegiance to doing things quickly, using common sense and simplicity. The canonical example of what they are trying to avoid was a 1980s program called CONFIRM. Funded by a consortium of hotels, airlines and rental-car companies, it was meant to be a comprehensive travel-reservation system. After three and a half years and $125m, it was cancelled.

The main principle of agile programming is that developers must talk to each other often, and that they must talk to the business people setting requirements equally often. Combine this with a short time-scale—ideally agile proponents seek to deliver a working bit of software every few weeks—and you have an accelerated, informal version of the iterative model. This means that no project can go on for years and produce nothing—a fatally flawed project will be caught sooner.

Gartner, a consultancy, estimates that agile programming will have a substantial impact on high-priority projects. Nonetheless, pessimists argue that the problems plaguing software development are so fundamental that none of the many innovations being pursued today will really make a difference. In mitigation, software engineering is still an immature discipline. It is just possible that the techniques now being pursued by Microsoft, IBM and their growing army of competitors will lead to a future where failure is an exception rather than the rule.

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Asian currencies

A need for flexibility

Nov 25th 2004
From The Economist print edition

Getty Images

There are welcome signs that Asian currencies are beginning to loosen up

THE dollar has taken a beating over the past week. In a speech on November 19th Alan Greenspan, the chairman of the Federal Reserve, admitted that America's current-account deficit was unsustainable, because foreigners' appetite for dollar assets could not increase forever. In other words, the greenback will fall. A few days later, a senior official at Russia's central bank said that the bank might increase the share of euros in its reserves. This pushed the euro to a new all-time high of almost $1.32. It also raised the prospect that Asian central banks might switch some of their vast reserves out of dollars.

Europeans have long complained that Asian governments' refusal to let their currencies rise against the dollar has put more upward pressure on the euro. So it is welcome news that several Asian currencies have been allowed to rise recently. The Japanese yen has gained 8% against the dollar since early October, hitting a four-and-a-half year high of ¥102.6. South Korea's won has risen by almost 10% over the same period, to a seven-year high. The Singapore and Taiwanese dollars are at their dearest for six and three years respectively. Has Asia lost its fear of floating?

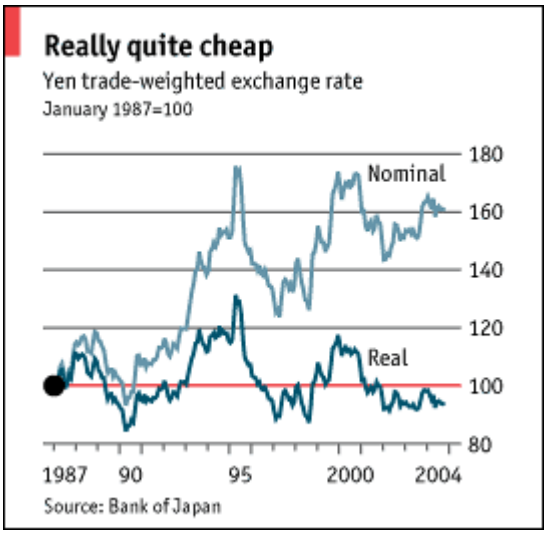
Not quite. After saying last week that it did not have a target for its exchange rate, South Korea's government did an about-turn this week and bought stacks of dollars in order to hold down the won. Consumer spending is weak after a credit-card boom turned to bust, and the government is keen to keep exports competitive.

A bigger issue for the foreign-exchange markets, however, is whether Japan will resume intervention. In the first quarter of this year, the Ministry of Finance sold yen worth $130 billion, but it has stayed out of the market since March, even though the yen-dollar rate is back to where it was in early 2004. Capital Economics, a London economic-research firm, reckons that Japan may now be prepared to tolerate a slightly stronger yen.

One reason is that the yen's trade-weighted index is lower than it was earlier in the year, because the Japanese currency has weakened against the euro. Furthermore, the yen's real trade-weighted value (ie, adjusting for inflation in different countries) is well below its average over the past decade (see chart). Because prices have fallen in Japan while they have risen in America, the yen's all-time peak against the

dollar of ¥80 in 1995 is equivalent to around ¥60 today.

Japanese intervention stopped soon after the release of GDP figures which confirmed that the recovery was hotting up. Some of that growth has since been revised down, and output stalled in the third quarter. But even on the revised figures, which will be published next month, real GDP grew by almost 3% in the year to the third quarter. Most important, deflation is receding. Figures due to be published on November 26th were widely expected to show the first year-on-year rise in consumer prices for five years.



This weakens the argument for Japan to buy dollars again, because one of the main reasons for intervention was to inject liquidity into the economy to fight deflation. Japan's finance ministry says that it would act against rapid increases in the yen. But renewed dollar purchases on the mammoth scale of early this year seem unlikely. Many economists expect the dollar to fall towards ¥95 next year.

Yuan for the money, two for the show

Although Europeans would be happier if the burden of the dollar's realignment were shared more evenly, Asian governments will continue to limit the appreciation in their currencies until China loosens its own peg against the dollar. Asia is arguably a yuan, not a dollar, zone. There is chatter about a revaluation of China's currency soon, but anyone expecting a big shift is likely to be disappointed. The Chinese authorities have said that they will move to a more flexible exchange rate, but they will not be rushed, because the country's financial system is not ready. Its fragile banking system could not cope with unpredictable swings in exchange rates.

A free float may be far off, but there are three short-term options. The first is to repeg the yuan to the dollar at a higher rate. The problem is that a modest revaluation—say of 5%, as some suggest—would doubtless fuel speculation that another rise was on the way, and so attract yet more hot capital inflows. Moreover, as the IMF has argued, it is not obvious that the yuan is undervalued by much. China's trade is in rough balance; and if capital controls were scrapped the yuan might even fall, as Chinese firms and households were allowed to invest in foreign-currency assets.

A second option is to widen the band within which the yuan trades against the dollar. Once again, however, a modest loosening of the band would probably invite speculation about a further step, driving the yuan to the top of its trading range.

The third and best option would be to switch the yuan's peg from the dollar to a basket of major currencies in an arrangement similar to Singapore's. That would allow a bit more flexibility against the dollar and help to discourage speculative capital inflows. It would also give China more control over its monetary policy. With a dollar peg, China's monetary policy is, in effect, being set by America's Federal Reserve, and is far too loose. This explains why inflation has been creeping up in China and elsewhere in the region. And it is the most likely reason why Asian countries will choose to allow their currencies to become more flexible.

Many economists expect China to shift to a currency basket next year. That would be a good reason to diversify its foreign exchange reserves. These total $515 billion, of which some 80% are thought to be in dollars. In fact, dollars comprise most of Asia's total reserves of more than $2 trillion. Should the dollar tumble, the region would face huge foreign-exchange losses. A study by the Federal Reserve Bank of New York calculates that a 10% rise in the yuan against the dollar would result in a loss in local currency terms equal to 3% of China's GDP; Singapore's equivalent loss would be as much as 10% of GDP.

There have been rumours that Asian central banks are starting to diversify their reserves. For a normal investor that would seem prudent. The dilemma, however, is that if all central banks tried to sell at once, the dollar would plunge, making big losses certain. Worse, yields on American Treasury bonds would rise—ie, bond prices and so the value of their bond holdings would also fall. Despite a sickly dollar, American bond yields have remained remarkably low for the very reason that Asian central banks have been buying huge quantities of Treasury bonds. If they halt their purchases, the value of those bonds will

slump. A more flexible investment strategy is needed, but how to achieve one is a bit of a conundrum.

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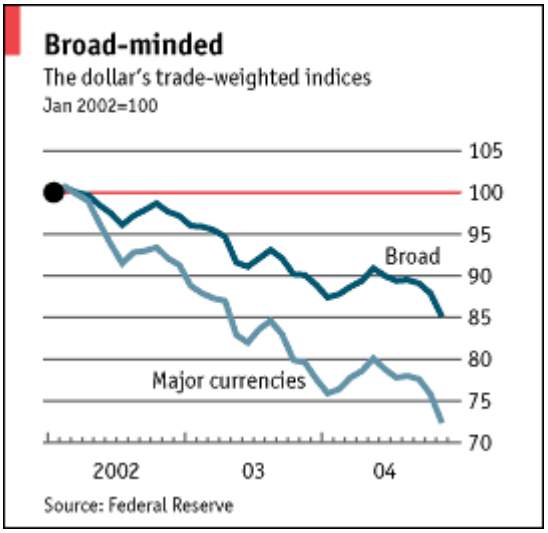
Exchange rates

Diversity in numbers

Nov 25th 2004
From The Economist print edition

By how much has the dollar fallen?

IN JANUARY 2002 one euro bought 86 cents: this week it was worth almost $1.32. The dollar has thus lost 35% against the euro, but by how much has it fallen against a basket of currencies, weighted by their importance in America's trade? Some say that since early 2002 the dollar's trade-weighted value has fallen by 27%; others insist on only 14%. Confusion arises because there are competing indices, including different currencies with different weights.



The chart shows the two indices published by America's Federal Reserve. The lower line shows the dollar's average fall against seven major currencies, such as the euro, the Canadian dollar and the pound. The upper line, the Fed's broad index, tracks the dollar against 27 currencies, including those of emerging economies, such as Mexico and China.

This makes a huge difference: the euro (against which the dollar has fallen by most) has a weight of 34% in the narrow index but only 19% in the broad index. But the dollar has risen against the Mexican peso in the past couple of years and has been fixed against the Chinese yuan. Together these have a weight of 21% in the broad index, so including them yields a smaller drop in the dollar.

To complicate things further, on our indicators pages we use trade-weighted rates calculated by the Bank of England and the IMF. For the dollar they give a similar result to the Fed's narrow index, but they have the advantage of covering all the developed world's currencies in a consistent way.

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Insurance

More claims

Nov 25th 2004 | NEW YORK
From The Economist print edition

AIG may have resolved one regulatory problem—and may have hit another

Landov

Poor Hank

FOR years, AIG appeared to be the oddest of creatures: an insurance company free of bad risks. Its streak may have come to an end. On November 23rd the world's biggest insurer announced a pending resolution with America's Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) of charges that it had helped two customers—PNC, a bank, and Brightpoint, a mobile-phone distributor—manipulate their earnings. A relieved stockmarket pushed the company's sagging share price up without even waiting to hear the terms. The next day, AIG disclosed that the settlement would cost it $126m. There was worse: a report in that day's *Wall Street Journal* that AIG's chief executive, Hank Greenberg, was under investigation by the DOJ for manipulating the company's share price in order to minimise the cost of its acquisition of American General in 2001.

Where all this leaves AIG is unclear. Unusually for such a big settlement, neither regulator has made any comment. So AIG's announcement might not be the whole story. The company's alleged offences strike at the heart of America's securities regulations, in which disclosure is paramount, because they distort the basic information on which markets feed. Many on Wall Street do not consider $126m a high penalty. But there may be stringent conditions attached to the settlement; and at least one other regulator believed to be looking into these deals, New York state's attorney-general Eliot Spitzer, has yet to weigh in.

The PNC and Brightpoint transactions were both intricate pieces of financial engineering that may have been replicated elsewhere in the industry. According to an earlier settlement with regulators by PNC, AIG created an off-balance sheet entity allowing the bank to hide loan losses. For Brightpoint, AIG provided an insurance policy that was essentially a loan, enabling it to spread over several years a loss that should have been recognised immediately. The result was “a ‘round-trip' of cash from Brightpoint to AIG and back to Brightpoint” that allowed earnings to be overstated by 61%, according to a settlement last year between AIG and the SEC.

The SEC has already censured AIG for suggesting that the PNC transaction was unique. The company had, said the SEC, engaged in five similar exercises. The Brightpoint deal is based on a concept known as “finite insurance” that, industry observers say, is common, especially between insurers and reinsurers (and was especially popular in the years between 1999 and 2001). Regulators' scrutiny of the area is intensifying. More than a dozen insurers are believed to have been subpoenaed recently to provide

information.

And then there is the *Wall Street Journal*'s story about AIG's autocratic, veteran chief executive. AIG says only that Mr Greenberg has not been contacted by the federal attorney's office, and so is not in a position to know about an investigation. Mr Greenberg, who is not averse to bawling out anyone saying anything critical of AIG or its share price, is said to have put pressure on the specialists handling AIG shares on the New York Stock Exchange (NYSE), in order to support their price in the days before the closing of the American General deal. This would have affected how many shares AIG had to pay for the acquired company. If true, this would cast a dim light on the way things were done at the NYSE, where Mr Greenberg used to sit on the board; but it need not constitute “fraudulent” manipulation, the normal standard in prosecutions.

Were all this not enough, AIG is still at the heart of another investigation into sleazy sales practices in the insurance industry. When the investigation was disclosed a month ago by Mr Spitzer, two AIG executives entered guilty pleas. On November 16th, additional guilty pleas were submitted by two senior underwriters at Zurich American Insurance for submitting fake insurance bids. According to the complaints, the bids were submitted in deals that involved AIG.

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America's stock exchanges

Trading for trouble

Nov 25th 2004 | WASHINGTON, DC
From The Economist print edition

Controversy over the SEC's "trade-through" proposals

TO ANYONE in the business of trading stocks, tiny changes in price can make an enormous difference. The same is true of small changes in trading rules. This week, America's brokers and exchanges are in an uproar over proposed trading rules being considered by the Securities and Exchange Commission (SEC). An alteration to the proposal would encourage stockmarkets to disclose more bid and offer prices—and thus in effect oblige brokers to look through different markets for all prices, not just the best ones, when they are filling orders. This, say some, could spell doom for floor trading on the New York Stock Exchange (NYSE).

The SEC is likely to vote on the proposals, which were first set out in February, on December 15th. But they are still in flux, and the SEC has not published the latest twist (which was reported by the *Wall Street Journal* on November 22nd). Many officials in the trading world are clamouring for formal publication of the changes and for a delay in the vote in order to allow more public comment.

The cause of the kerfuffle is known as the "trade-through" rule. This obliges markets to ensure that customers get the best price rather than simply the fastest execution. Currently it applies to the NYSE and the American Stock Exchange. The SEC's proposal would extend it to the NASDAQ and other markets, and seeks to ensure that quotes be available electronically in order to be considered as a possible best price. Customers may be able to opt out if they value speed above price.

The NYSE,unlike the electronic NASDAQ, retains a floor broking system, which is allowed to take as long as 30 seconds to confirm or reject orders. While the time ticks away, critics say, the desired price may vanish—as do the nearly-as-good prices offered more speedily by electronic rivals. To fix the problem, the NYSE plans a hybrid system that would increase trading through its automated system, which now handles just 10% of share volume.

So why all the fuss? Under the latest version of the SEC proposal, if an exchange wants to be hit when investors are looking for the best prices, then it apparently must publish its entire list of bids and offers in the stock, rather than just its single best price. This means that an investor looking to buy 500 shares of a stock at any price under $20 might see first, say, an offer of 100 shares at $19.97 on Market A, then another 200 shares at $19.98 on the same market, before seeing the chance to buy all 500 at a pricier, but acceptable, $19.99 on Market B. Some gripe that this will result in extra processing costs.

If this proposal is approved, the NYSE's open-outcry system looks endangered. One reason is that floor traders often keep their big orders hidden, lest knowledge of them move the market. If the SEC requires that those orders be displayed, in order to be hit when others are going through their price lists, the appeal of the floor may wane. Brokers could keep hiding orders, but if they did they would probably get less business.

The irony in all this is that, at present, the NYSE's floor traders rely on the trade-through rule for their very survival. Without it, liquidity on the exchange might dry up as speedier electronic competitors seized a greater share of trading. Now the extension of the trade-through rule, to more markets and more orders, is also a threat. John Thain, the NYSE's chief executive, could yet have to hurry past his hybrid idea and move to fully electronic trading much more quickly. Or he must join with other dissidents to convince the SEC to tweak its proposals yet again.

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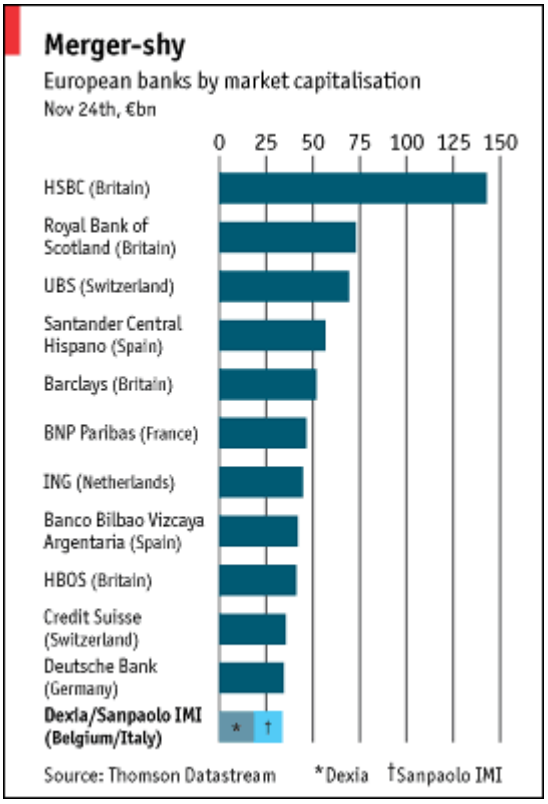
European banks

Flirting

Nov 25th 2004 | PARIS AND TURIN
From The Economist print edition

The trouble with cross-border mergers



FOR many months, Pierre Richard, boss of Dexia, a Franco-Belgian bank, and Enrico Salza, his counterpart at Italy's Sanpaolo IMI, have been in secret talks about a merger. When the truth leaked out last week, shareholders of both banks were surprised and displeased. On November 22nd Dexia's three largest shareholders forced Mr Richard to suspend talks until a board meeting on November 28th. Meanwhile, members of Sanpaolo's executive committee grilled Mr Salza in Turin, the bank's home city.

A merger may still happen, creating the euro area's sixth-largest bank by market value (but only the 12th-biggest in Europe as a whole—see chart). It would also be a rare example of a cross-border European bank merger, following the recent purchase by Spain's top bank, Santander Central Hispano, of Britain's Abbey. Analysts and investors were sniffy about that deal, and they may be even sniffier about this one. Derek De Vries, an analyst at Merrill Lynch, estimates that merging Dexia and Sanpaolo would yield €317m ($242m) in cost savings: the all-French takeover of Crédit Lyonnais by Crédit Agricole, an operation of comparable scope, threw up €720m.

Dexia and Sanpaolo are not in great shape. Dexia's main business is lending to municipalities, a dull business with low growth. It is burdened by the acquisition of two Dutch banks, Banque Labouchère in 2000 and Kempen the following year. Sanpaolo is essentially an Italian retail bank. It is weaker than its main rivals, UniCredito and Banca Intesa. Because Sanpaolo is still digesting the merger of a host of sparring regional banks its corporate governance is, in Mr Salza's words, a *telenovella* (soap opera): until recently the bank had three chief executives.

Why then do Mr Richard and Mr Salza want to merge? Mr Richard does not want his bank to fall prey to BNP Paribas or Société Générale, two big, cash-rich French banks. Mr Salza too would rather link up with a bank of similar size than be swallowed by a bigger one. Emilio Botín, the chairman of Banco Santander, which owns 8.6% of Sanpaolo, recently hinted at an appetite for the entire bank.

Mr Richard is still hoping to make his binational bank more European. However, economic nationalism remains a powerful obstacle to cross-border mergers. Dexia's three main shareholders, which together control 38% of its shares, want to keep the bank predominantly Belgian. France's Caisse de Dépôts et Consignations, on the other hand, owner of 7.9% of Dexia and 1.9% of Sanpaolo, is in favour of a merger. Mr Salza is not giving up either. On November 23rd Alfonso Iozzo, Mr Salza's right-hand man, visited Antonio Fazio, the governor of the Bank of Italy, to win the regulator's approval of the proposed deal. In the past Mr Fazio has blocked attempts by foreigners to buy more than 20% of an Italian bank.

A merger of Dexia and Sanpaolo would be unlikely to set off a wave of similar deals, although there may be surprises. Analysts at Société Générale say Spain's Banco Bilbao Vizcaya Argentaria could buy Italy's Banca Nazionale del Lavoro, a troubled bank currently selling €1.2 billion in new shares. UniCredito could join forces with Sabadell or Popular to enter the Spanish market. But in most countries, including Italy, there are still gains to be had from domestic consolidation. Alessandro Roccati of Fox-Pitt, Kelton, an

investment bank, thinks next year could see some deals between Italian banks. Cassa di Risparmio di Firenze, a Tuscan savings bank, is a takeover candidate. Capitalia, a Roman bank, and Banca Antonveneta, from the Veneto region, might join forces.

For Dexia and Sanpaolo, much depends on Mr Richard's powers of persuasion this weekend. Mr Richard and Mr Salza may have to content themselves with a looser alliance—or none at all. If no form of link materialises between the two banks, Mr Richard is unlikely to see out his contract, which expires in 2006. A redrawing of Europe's banking map still looks a long way off.

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Iraq's debts

A load off?

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The Paris Club deal is not the end of the haggling over Iraqi debt

AFP

Ready for business as usual

FOR once, good news for Iraq. Its rich-country creditors, France, Germany and Russia, have agreed to forgive 80% of their $38.9 billion of Iraqi sovereign debt. The write-offs will come in parts: 30% of the debt now, another 30% in 2005 and a final 20% in 2008. The restructuring, done under the auspices of the Paris Club, an informal group of western creditor countries, came earlier than expected and just in time for the first round of Iraqi elections expected in January.

Generous or not, the deal owed nothing to the notion that Iraq's debts were “odious”, incurred by a tyrannical government and therefore unworthy of repayment. The motivation is mostly political. America's government lobbied European countries to support post-war Iraq, and the Europeans surely saw the deal as a way to mend transatlantic ties.

Yet debts held by the Paris Club are only around a third of Iraq's total sovereign obligations. According to Richard Segal of Exotix, an emerging-market-debt trading firm, debt owed to Gulf states, which amounts to around $49 billion, is likely to come up next for negotiation. Other countries, including China, Turkey and ex-communist central European countries are owed around $16 billion. The claims of commercial creditors, including loans grouped under the London Club and other private claims, total a further $12 billion. This includes the Washington Club, a group of big companies, the biggest of which is South Korea's Hyundai, seeking $2 billion for building hospitals and power stations in the 1970s and 1980s.

What will the Paris Club deal mean for Iraq's debts to western companies and banks? One London fund manager bristles at the suggestion that it will, or should, have any effect. The Paris Club loans were politically motivated, he says, as was the forgiving of them. Past experience in Russia and elsewhere does not support the idea that other creditors must follow where the Paris Club leads. What will make a difference is Iraq's desire one day to re-enter the global capital markets. For this reason, he says, the Iraqis should press for a write-down of no more than 30%.

Mr Segal, however, thinks that none of Iraq's creditors is likely to escape with a write-down lower than 65-70%. That is in part thanks to the requirement of “comparability” written into the Paris Club agreement, meaning in essence that a debtor nation should not give better terms to other creditors. A particularly sticky point will come when poor countries such as Bulgaria and Romania negotiate with oil-

rich Iraq. They may not feel as generous as France and Germany.

Thanks to Iraq's oil, however, there is plenty of room to haggle. Some creditors may be offered derivative contracts that will pay them handsomely if Iraq's economic or oil-export growth is faster than expected, as has been tried in Mexico and Venezuela. But Iraq is no ordinary debtor. America will no doubt continue to have an influence on any negotiations.

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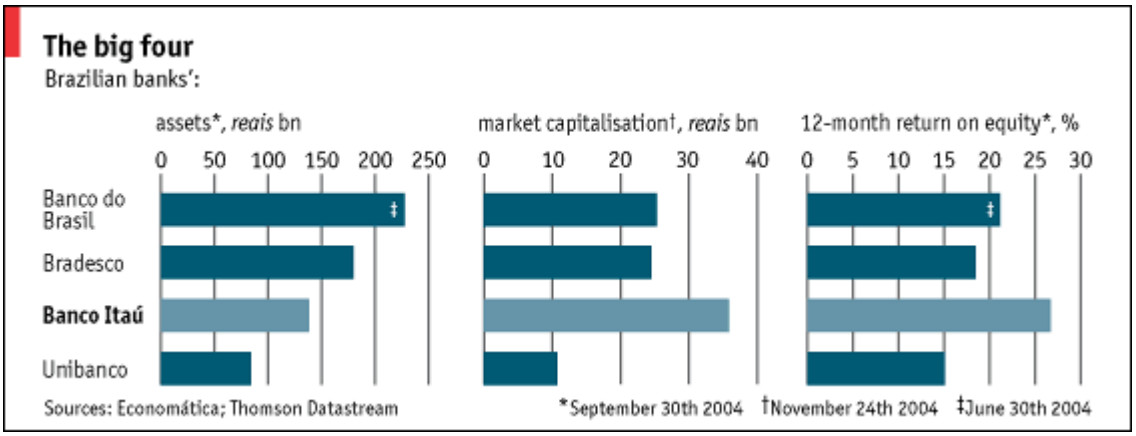
Brazilian banks

Calmer water, harder task

Nov 25th 2004 | SÃO PAULO
From The Economist print edition



Banco Itaú has made the most of turbulent times to become Brazil's most successful bank. Now for normality

IN A country with real interest rates among the world's highest, a bank does not have to know much about banking to make money. As long as it can get cheap deposits, it will find profitable places to park them. In Brazil, where the basic interest rate is 17.25% and inflation is ten percentage points lower, banks are masters of this game. Last year they reported near-record profits while the economy shrank and business howled. In the first three quarters of 2004, the four biggest privately owned banks raised profits by a further 17%.

No bank plays this game better than Banco Itaú. Although, measured by assets, it is merely Brazil's fourth-biggest bank (behind two other listed institutions and Caixa Econômica Federal, a state savings bank), its market capitalisation of 36 billion *reais* ($13 billion) makes it the most valuable in Latin America. Its profitability is the envy of its rivals and it has capital to spare for expansion.

But now the rules are changing. Interest rates have come down sharply from their 2003 peak of 26.5%. Though they have lately crept up again, they are likely to resume their fall. For most of the year the *real* has been boringly stuck at around three to the dollar, and growth is expected to be moderate this year and next. Brazil, in other words, is beginning to resemble a normal economy. How will Itaú, the champion surfer, handle calmer water?

Probably with aplomb. Its main talent lies in adapting to changes in financial conditions, which have been frequent: Itaú has been “able to push the right products during each period”, says its boss, Roberto Setúbal. The secret sounds banal: “clear objectives”, above all increasing earnings per share. What distinguishes Itaú is its ruthlessness in pursuit of that goal, whether in weighing up acquisitions, in pricing its products or in paying its executives. Its main competitors are handicapped in this regard. Banco do Brasil, the state-owned giant, last week got rid of its chief executive because of political pressure. Bradesco, the private-sector leader, is partly owned by a charity. Itaú, by contrast, is controlled by two families, the Setúbals and the Villelas. It pursues profitability “with a tenacity that is amazing”, says Antonio Bento Furtado de Mendonça Neto, a former Itaú executive who now heads the Brazilian arm of Solving International, a French consultancy.

In 1994, when Mr Setúbal took over from his father, Itaú was “changing environment and generations at the same time.” Brazil had recently stopped telling banks to whom they should lend and at what price, and was in the process of slaying hyperinflation. The Citibank-schooled Mr Setúbal instituted a stock-option programme for executives and then went shopping, buying “a bank a year for six or seven years”

in privatisations or by picking off weaker rivals. These purchases, mostly of retail banks, have doubled Itaú's customers without increasing the staff, he says. According to Paul Tucker, an analyst at Merrill Lynch, Itaú has 18.5 employees per branch, against Bradesco's 24.

Meanwhile, Itaú positioned itself to profit from the various crises (Mexican, Asian, Russian and Argentine) slamming into Brazil. It has not one treasury operation but three (one each for the retail and corporate banks plus one for Itaú's own account). This spurs both competition and caution among them. A big part of Itaú's profit in 2002 came from a bet against the *real*, which duly slumped because traders panicked at the thought of the left-wing Luiz Inácio Lula da Silva being elected Brazil's president. That did not stop Mr Setúbal from being one of the first company bosses to speak up for Lula, who won.

Under Lula, the environment is changing again. Lower rates, less volatility and a squeeze on lending spreads cost Itaú 450m *reais* of revenue between 2002 and 2003. But profits in the first three quarters of 2004 were 1.1 billion *reais* higher than two years before. Defaults fell, which helped, but Itaú also reshaped its portfolio. Its loans jumped, by 59% to individuals and by 181% to small businesses, while its government-bond portfolio shrank by 18%.

Normality has touched off what Mr Tucker calls “almost a land grab” for the mass market, and Itaú has been in the thick of it. This year it formed a joint venture in consumer finance with the owner of Pão de Açúcar, a supermarket chain, and this month, with Citigroup, it bought out Unibanco's share of Credicard, Brazil's largest credit-card issuer. Itaú also knows when to say no. It pursued the local consumer-credit division of Lloyds TSB, a British bank—until the price rose too high.

If Itaú has a weakness, it is that customers are not treated as royally as shareholders. Itaú boasts that its brand is Brazil's most valuable, but its competitors often walk off with top industry prices for insurance and investment funds. Fortunately for Itaú, changing banks in Brazil is as easy as rollerskating through a rainforest.

That could change as competition stiffens. Bruno Pereira, an analyst at UBS, expects Brazil to “attract more attention” from the likes of Citigroup and HSBC. State banks may be tempted to grow by cutting spreads, forcing the private sector to follow suit. Mr Mendonça Neto argues that the costs of all banks, including Itaú, are still too high. Brazil has double the number of ATMs it needs, for example, in part because banks refuse to share them. Competition may lead to another shake-out, he thinks, with today's big eight retail banks reconfiguring into three, one of them a Brazilian private-sector bank. If so, the chances are that it will be Itaú.

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Economics focus

A promising alternative

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In the alternative minimum tax, America may have a ready-made route to tax reform

GEORGE BUSH wants to overhaul America's tax code. The newly re-elected president has declared tax reform to be a top economic goal for his second term, alongside the revamping of Social Security (the public pension system). A commission is being set up, to mull over options. Washington's tax wonks are busily speculating about what Mr Bush might do.

So far, the president has done no more than mention general principles. He wants to make the tax code simpler and fairer, and to encourage saving and investment. He wants to eliminate loopholes—although he has also hinted that some tax incentives for buying homes and giving to charity must stay. In addition, he has promised that reform will not mean an increase in the total taxes Americans pay.

Much of this makes sense. To economists, a good tax system is one that raises money with minimal distortion to the economy. That means marginal tax rates should be low and the tax base should be broad, with few if any exemptions. The system should be simple, to keep down the costs of compliance and monitoring. America's tax system falls far short of this ideal. It is monstrously complicated. The cost of complying with taxes is estimated to be well over $100 billion a year, or more than 10% of income-tax receipts. A lot of the trouble is that America's tax code is not only a means of raising money, but also the government's main social-policy tool, not to mention a prime source of pork-barrel patronage dispensed by congressmen. Refundable tax credits are also the chief form of income support for the working poor. When politicians want to encourage home ownership, the purchase of health insurance or attendance at college, or merely to help a favoured industry, they reach for tax breaks.

All this makes the chances of radical reform slim. Nonetheless, some change is possible, thanks to the alternative minimum tax (AMT). Introduced in 1969, this little-known back-up to the income tax was designed to ensure that rich Americans could not avoid paying income tax entirely by claiming too many deductions. It allows fewer deductions than the normal income tax (mortgage interest, donations to charity and a few other things). It is also less progressive, with two rates, of 26% and 28%, levied on income above a certain, tax-free amount, which for a married couple has long been $45,000. Under today's law, Americans have to pay either income tax or the AMT, whichever is higher.

Until recently, few Americans owed more under the AMT than under the standard system. Only 1.3m people paid the AMT in 2000. But because the AMT's tax-exempt amount is not indexed to inflation and because Mr Bush's tax cuts are reducing Americans' bills under the standard income-tax, the number of AMT payers is rising and is set to climb dramatically in the next few years. The number is already 3m. According to economists at the Tax Policy Centre in Washington, DC, by 2010 it could reach almost 30m, around one in four taxpayers.

Not the problem, but the solution

Most politicians regard the advance of the AMT as a problem that needs to be fixed. The notion that 30m Americans would be forced to calculate their tax liabilities twice and that they would lose their many (popular) tax incentives, particularly deductions for children, is seen as politically unfeasible. Already the exemption has been raised, temporarily, to $58,000, to keep a lid on the number paying the AMT. Unfortunately, this will be an expensive course to maintain. Increasing the exemption in line with inflation would cost $400 billion in forgone tax revenue over the next decade. If Mr Bush's tax cuts are made permanent, that figure rises to over $600 billion.

From the perspective of tax reform, however, the AMT is less an expensive problem than an opportunity. Why not use the AMT as the vehicle for tax reform? By 2009, it will be less costly to ditch the income tax and keep the AMT than to repeal the AMT and carry on with the income tax. The AMT is far from perfect—its personal exemption is not indexed; quirks in its structure can mean high marginal rates for some taxpayers; and it allows some needless deductions—but it is less riddled with loopholes than the current income tax. Thus it is a good starting-place for base-broadening, exemption-ending reform.

In theory, it might be better to shift to a national sales tax, a flat tax or another type of consumption tax than to pursue tax reform via the AMT. But practicalities count too, and the advance of the AMT could be used to make big improvements on the income tax. The AMT could be made more progressive, and the most popular incentives of today's income tax retained, without bringing in all the more outrageous exemptions. This could be a stepping stone to further change later.

Michael Graetz, a tax expert at Yale University, has come up with an innovative way to do this. He proposes simplifying America's tax code dramatically. He would replace the income tax with the AMT, but with an exemption of $100,000 per family and a single rate of 25%. With a $100,000 exemption, only 25m people would need to pay income taxes, around one-fifth of today's figure. To make up for the lost revenue, Mr Graetz suggests introducing a value-added tax of between 10% and 15%. This would shift the tax base towards consumption rather than income, and would thus be friendlier to saving. Marginal rates would be low. And the system would be simpler. To retain progressivity and mitigate the impact on the poor, Mr Graetz suggests that poorer Americans could get tax relief on their contributions to Social Security.

Taken together, Mr Graetz's plans imply a wholesale change to America's tax system. That may render them politically unrealistic. Nonetheless, the looming AMT crisis suggests that America has a rare opportunity to clean up its tax code. If he is really serious about reform, Mr Bush should grasp it.

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Women and HIV

The new face of AIDS

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Getty Images

Women will soon be a majority of those infected with HIV. Male chauvinism is largely to blame

CHARLENE SMITH, a South African woman who was raped in 1999, has since then campaigned against sexual violence and for the free provision of anti-retroviral drugs to prevent rape victims contracting HIV, the virus that causes AIDS. Neither of these stances, you might imagine, would be controversial.

But both have enraged South Africa's president, Thabo Mbeki, who accuses Ms Smith, who happens to be white, of spreading the racist myth that African men are “rampant sexual beasts, unable to control our urges, unable to keep our legs crossed, unable to keep it in our pants,” as he told the country's parliament last month.

The latest report on the global AIDS epidemic, released by UNAIDS this week, makes depressing reading, as usual. There were an estimated 4.9m new infections in 2004, and 3.1m people died of AIDS. About 40m people are now infected, a small majority of whom are male. But women are catching up fast. In sub-Saharan Africa, 57% of those infected are female. Among young South Africans, Zambians and Zimbabweans the figure is three-quarters.

To fight the disease, one has to understand how it spreads. And one of the most striking aspects of the virus's passage from male to female bloodstreams is how little say women have had in the matter. Men tend to contract HIV because of things they have done; women are more likely to contract it because of things that have been done to them.

Rape is part of the problem. Violent, bloody sex is much more likely to result in infection than the consensual variety, and is much more common than many people believe. In rural Peru, for example, 24% of young women say they lost their virginity to a rapist. In a recent national survey in South Africa, 10% of sexually experienced young women said they had been raped.

Less obviously, domestic violence contributes to the spread of HIV. Women whose husbands or boyfriends beat them are more likely to be infected. This may be because men who beat their wives are also likely to be inconsiderate in other ways, such as sleeping with prostitutes and not caring whether this endangers their wives. Or it may be because beaten women are often too afraid to say no to sex, or to ask their partners to use condoms. In Zambia, for example, only 11% of women thought they had a right to ask their husband to wear a condom, even if they knew he was unfaithful and HIV-positive.

AIDS specialists are sceptical about the efficacy of promoting sexual abstinence (a policy advocated by the American government), but Kathleen Cravero, UNAIDS's deputy director, thinks governments should be promoting the “right to abstain”. Mr Mbeki says this makes her a racist, but there may be something in the idea. Programmes teaching schoolgirls that they have a right to say no, and explaining to schoolboys that they have a duty to listen, are being tried out in Uganda and South Africa. It helps if both sexes are also taught how to talk to each other, and how to deal with relationships.

In general, the less educated a woman is, the greater the risk she will contract HIV. And ignorance about sex and AIDS is widespread. In Vietnam, two-thirds of young women could not name three methods of avoiding AIDS. In rural Uttar Pradesh, an Indian state, 83% of married women surveyed said that before they moved in with their husbands, they did not know how women become pregnant.

Educated women tend to be more assertive, partly because they tend to earn more and so are less dependent on their husbands. UNAIDS argues for the abolition of primary- and secondary-school fees, not only because it would make it easier for impoverished girls to attend school, but also because it would remove an important incentive to sell sex.

In several poor countries, according to Dr Cravero, most women who engage in prostitution, or who form relationships with older “sugar daddies”, do so in order to pay school fees; either for themselves or for their siblings or children. Sex between old men and young women is a crucial factor in the spread of the epidemic. A survey in Kenya, for example, found that among women whose husbands were no more than three years older, none was HIV positive, but among those whose husbands were a decade or more older, half were.

Wealthy older men can afford many sexual partners, and often prefer them young. Their dalliances with younger women keep the virus circulating between generations. Young women are at greater risk of contracting HIV, because the lining of the neck of an immature womb is less tough. It does not help that many old men believe that because younger women are “pure”, they need not wear condoms. Nor does it help that some believe they can cure themselves of venereal diseases by sleeping with a virgin.

Economic inequality between the sexes aggravates matters. The burden of caring for AIDS-sick husbands and children falls almost entirely on women. In Africa and South Asia, discriminatory inheritance customs mean that when a husband dies, his family may grab the property, leaving his widow, who may be infected, penniless as well. She may then sell her body to survive.

Many of these problems would abate if people were richer. Women are less inclined to put up with abusive husbands when they can easily find jobs. Prostitution is rarer when it is not the only alternative to destitution. But the economies of many of the countries worst-affected by AIDS are, partly as a consequence of the epidemic, growing slowly or not at all. And a disease that creates the conditions that favour its spread is the most dangerous disease of all.

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Health care in poor countries

Doctors' dilemma

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From The Economist print edition

Africa desperately needs more health-care workers

WHILE much of the attention on fighting AIDS and other diseases in poor countries has focused on access to affordable drugs, concern is now shifting to the question of who, exactly, will deliver them. Unfortunately, there is a severe shortage of doctors, nurses and other health-care workers in these countries. According to a report published in this week's *Lancet* by the Joint Learning Initiative (JLI), an international consortium of academic centres and development agencies, sub-Saharan Africa has only one-tenth the number of nurses and doctors per head of population that Europe does, though its health-care problems are far more pressing. The reasons for this are two-fold, and well known—not enough health-care workers are trained in the first place, and too many of those who are trained then leave for better-paid jobs in the rich world. What the report does is to put some numbers on these problems.

A mere 5,000 doctors, it finds, graduate in Africa each year (a third of the number that graduate in America). Only 50 of 600 doctors trained in Zambia in recent years are still in the country. There are more Malawian doctors in Manchester than Malawi. And many rich countries exacerbate the problem by recruiting from poor ones to help deal with their own shortages.

To overcome all this, the JLI reckons that the world needs 4m more health-care workers, of whom 1m are required in sub-Saharan Africa alone. The question is, who will pay for them? The report floats some ideas. It recommends that roughly $400m, or 4% of the overseas aid currently spent on health, be earmarked to help build up the health-care workforce in poor countries. But it also suggests that better use be made of existing resources, for example by employing local volunteers rather than highly trained doctors for many routine matters. As Lincoln Chen of Harvard University, one of the report's authors, points out, a few countries, such as Brazil, Thailand and Iran, have taken steps in the right direction. Others need to follow their lead.

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Finding forgeries

Different strokes

Nov 25th 2004
From The Economist print edition

A new way of detecting forged works of art

Pietro Vannucci, called Perugino, and workshop
Madonna and Child with Saints Anthony Abbot, James, Francis, and Benedict
about 1505, oil and tempura on panel
Hood Museum of Art, Dartmouth College, Hanover, NH

Is it is or is it ain't his baby?

SCIENCE has been used to authenticate art for quite a long time. The chemical composition of paints has been examined, and some paints have even been radioactively dated (it is the lead content that is key here). But, until recently, the common factor in all the science used to figure out if a piece of art was forged was that it was concerned with the medium of the artwork, rather than the art itself. Matters of style and form were left to art historians, who could make erudite, but qualitative, judgments about whether a painting was really good enough to be, say, a Leonardo. But this is changing. A paper in this week's *Proceedings of the National Academy of Sciences* by Hany Farid and his colleagues at Dartmouth College in New Hampshire uses statistical techniques to examine art itself—the message, not the medium.

Dr Farid employed a technique called wavelet analysis to examine 13 drawings that had at one time or another been attributed to Pieter Bruegel the Elder, a 16th-century Flemish painter. He also looked at Perugino's “Madonna with Child”, a 15th-century Italian masterpiece lodged in the college's Hood Museum of Art. He concluded, in agreement with art historians, that eight of the putative Bruegels are authentic, while the other five are imitations. In the case of “Madonna with Child”, he analysed the six faces in the painting (Mary, the infant Jesus and several saints) and found that three of them were probably done by the same painter, while the other three were each done by a different hand. The view that four different painters worked on the canvas is, he says, consistent with the view of some art historians that Perugino's apprentices did much of the work, although there is no clear consensus among art historians.

As sceptics will doubtless point out, this is a small number of images. Furthermore, Dr Farid knew before performing the analysis what results he expected. But he is the first to acknowledge that it is early days for his methodology. He hopes to study many more paintings. Although the computations involved are not trivial (they take about ten hours on a relatively powerful cluster of four Linux workstations) the limiting factor is getting sufficiently-high-resolution digital scans of paintings from museums. By looking at large numbers of paintings that are universally believed to be authentic, Dr Farid hopes to be able to examine doubtful cases with confidence in the future.

Even with the Bruegels—real and imitation—though, Dr Farid's results are persuasive. It is tricky to describe exactly what it is that distinguishes the real ones from the imitations, but Dr Farid says that it can be thought of as the nature of the artist's brushstroke. Unlike some analyses of Jackson Pollock's work that have been done over the past few years by Richard Taylor of the University of Oregon, Dr Farid says his technique could, in principle, be used for any artist. Dr Taylor had, in an ingenious insight, looked at the “fractal dimensions” of Pollock's work (roughly speaking, how much Pollock's drippy canvases resembled themselves at different length scales) and found distinguishing characteristics unique to Pollock. But not every artist paints in a seemingly chaotic way that is amenable to such analysis.

Dr Farid, on the other hand, used techniques that had evolved from his investigations into digital images. His initial concerns had been twofold: to determine whether such an image had been manipulated, and to work out whether an image represented physical reality or was a high-quality but completely synthetic picture. In both of these cases, he found a number of statistical signatures of real, undoctored images that were not present in doctored or fake images, as well as statistical blips which appear in doctored or

fake images but not in real ones. This was a bit easier than comparing paintings made by different people. The statistical signatures of digitally manipulated images tend to stand out, while the differences between painters are more subtle.

What Dr Farid did was to convert each work of art into a set of mathematical functions. These so-called wavelets describe particular parts of the image as a series of peaks and troughs of variable height and wavelength. By expressing an image this way, it is possible to compress that image while losing very little information. The sums of the wavelets from different images can then be compared. Once he did this, Dr Farid found that the types of wavelets used to express authentic Bruegels were noticeably different from those used to express the imitations. (The Perugino was analysed by treating the six faces as distinct paintings.) It seems that curators may soon be able to add another weapon to their anti-forgery arsenal.

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About sponsorship

Genetics and smoking

Smoke and fire

Nov 25th 2004
From The Economist print edition

Addiction to nicotine may be in the genes

MARK TWAIN once observed that giving up smoking is easy. He knew, because he'd done it hundreds of times himself. Giving up for ever is a trifle more difficult, apparently, and it is well known that it is much more difficult for some people than for others. Why is this so?

Few doctors believe any longer that it is simply a question of will power. And for those people that continue to view addicts as merely “weak”, recent genetic research may force a rethink. A study conducted by Jacqueline Vink, of the Free University of Amsterdam, used a database called the Netherlands Twin Register to analyse the smoking habits of twins. Her results, published in the *Pharmacogenomics Journal,* suggest that an individual's degree of nicotine dependence, and even the number of cigarettes he smokes per day, are strongly genetically influenced.

The Netherlands Twin Register is a voluntary database that contains details of some 7,000 pairs of adult twins (aged between 15 and 70) and 28,000 pairs of childhood twins. Such databases are prized by geneticists because they allow the comparison of identical twins (who share all their genes) with fraternal twins (who share half). In this case, however, Dr Vink did not make use of that fact. For her, the database was merely a convenient repository of information. Instead of comparing identical and fraternal twins, she concentrated on the adult fraternal twins, most of whom had completed questionnaires about their habits, including smoking, and 536 of whom had given DNA samples to the register.

The human genome is huge. It consists of billions of DNA “letters”, some of which can be strung together to make sense (the genes) but many of which have either no function, or an unknown function. To follow what is going on, geneticists rely on markers they have identified within the genome. These are places where the genetic letters may vary between individuals. If a particular variant is routinely associated with a particular physical feature or a behaviour pattern, it suggests that a particular version of a nearby gene is influencing that feature or behaviour.

Dr Vink found four markers which seemed to be associated with smoking. They were on chromosomes 3, 6, 10 and 14, suggesting that at least four genes are involved. She is particularly excited about the result from chromosome 6, as the marker here is close to a cluster of genes of a type known as glutathione S-transferase alpha genes.

These genes carry the instructions for making enzymes that detoxify a range of destructive chemicals, including some that are known to cause cancer. They seem to be especially active in cells in the lining of the lungs and the intestine. Previous work has shown that variation in these genes changes people's susceptibility to the cancer-causing chemicals they detoxify, and also affects the toxicity and efficacy of some drugs.

Whether or not glutathione S-transferase alpha genes are involved, Dr Vink hopes that finding genes responsible for nicotine dependence will make it possible to identify the causes of such dependence. That will help to classify smokers better (some are social smokers while others are physically addicted) and thus enable “quitting” programmes to be customised.

Results such as Dr Vink's must be interpreted with care. Association studies, as such projects are known, have a disturbing habit of disappearing, as it were, in a puff of smoke when someone tries to replicate them. But if Dr Vink really has exposed a genetic link with addiction, then Mark Twain's problem may eventually become a thing of the past.

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Books of the year 2004

Feet up, volume down

Nov 25th 2004
From The Economist print edition

We choose the year's best books, and tell you about those our own writers published in 2004

Fiction and memoirs

The Plot Against America. By Philip Roth. *Houghton Mifflin; 400 pages; $26. Jonathan Cape; £16.99*

A novel about what happens to one Jewish family—the Roths of Newark, indeed—when America's welcome is gradually rescinded. The book imagines a nasty turn in American politics in the 1930s, when Charles Lindbergh, an aviator with strong Nazi sympathies, wins the presidential election on an isolationist ticket. An extraordinary description of how history can encroach upon ordinary lives.

The Master. By Colm Toibin. *Scribner; 352 pages; $25. Picador; £15.99*

In this novel, short-listed for the Man Booker prize, the author insinuates himself under the skin of Henry James, covering not only the known episodes in the literary lion's life, but also imagining the darker corners. One of a handful of recent novels that have to do with James, Mr Toibin's portrayal of innocence, shyness and even wisdom confirms him as a master craftsman.

Snow. By Orhan Pamuk. *Knopf; 448 pages; $26. Faber and Faber; £12.99*

A novel about the tensions between Turkey's urban, secularist elite and their long-derided Islamist opponents. By the leading interpreter of Turkish society to the western world, it deals with such familiar Pamuk themes as faith, identity and betrayal.

I'll Go to Bed at Noon. By Gerard Woodward. *Chatto and Windus; 440 pages; £12.99. To be published in America by Vintage in February*

A summer idyll ends in tragedy. The best depiction of alcoholism since Kingsley Amis.

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The Amateur Marriage. By Anne Tyler. *Knopf; 306 pages; $24.95. Chatto & Windus; £16.99*

Spanning 60 years, Anne Tyler's novel is a melancholic story of a mismatched marriage. The complexities of family life in mesmerising detail.

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The Line of Beauty. By Alan Hollinghurst. *Bloomsbury; 400 pages; $24.95. Picador; £16.99*

In this year's winner of the Man Booker prize, a shy Henry James-loving leech moves into the house of a Tory politician and immerses himself in gay sex. A depiction of Thatcher-era London done with great literary skill.

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Cloud Atlas. By David Mitchell. *Random House; 528 pages; $14.95. Sceptre; £16.99*

In this feat of brilliant pyrotechnics, six interlocking stories mix the voices, among others, of a journalist in Governor Ronald Reagan's California and a voyager crossing the Pacific in the mid-19th century.

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About Love and Other Stories. By Anton Chekhov. *Translated by Rosamund Bartlett. Oxford University Press; 246 pages; $8.95 and £7.99*

Seventeen peerless examples of how much life you can put into a few pages of fiction if you have Chekhov's economical mind, his eyes and ears, his feel for comedy and his sense of humanity. Chekhov is better known for his plays. But these are small masterpieces of their own, in a revelatory new translation.

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The Lambs of London. By Peter Ackroyd. *Chatto and Windus; 228 pages; £15.99*

A novel of intrigue set around a small bookshop in Holborn Passage in 19th-century London and the discovery of a document in Shakespeare's own writing. The Lambs are a young brother and a sister taken into the confidence of a 17-year-old antiquarian. As clever and vivid as any work of Mr Ackroyd, a man deeply at home in the London of the past.

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A Tale of Love and Darkness. By Amos Oz. *Harcourt; 544 pages; $26. Chatto & Windus; £17.99*

A deeply sensitive memoir of the Israeli novelist's childhood and adolescence, from Lithuania to Jerusalem. At times funny, at times tragic, Amos Oz weaves his family's history into the broader story of the birth of Israel, attended by blood.

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History

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The Command of the Ocean: A Naval History of Britain, 1649-1815. By N.A.M. Rodger. *Penguin/Allen Lane; 907 pages; £30*

A timely reminder of the vital role the sea has played in the development of Britain's heritage and culture. Scholarly and erudite but also a thrilling story, told with wit and verve.

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The Last Valley: Dien Bien Phu and the French Defeat in Vietnam. By Martin Windrow. *Weidenfeld & Nicolson; 734 pages; £25*

The definitive account of France's military involvement in Vietnam, and a meticulous though fluid account of the final showdown.

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In Tasmania. By Nicholas Shakespeare. *The Harvill Press; 320 pages; £20*

For many people, Tasmania is an island of the imagination, distant and alluring. Nicholas Shakespeare weaves a cast of unlikely characters into 200 years of Tasmanian history.

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Maximum City: Bombay Lost and Found. By Suketu Mehta. *Knopf; 560 pages; $27.95. To be published in Britain in February by Review Books*

Suketu Mehta tells the stories of slum-dwellers, dancing girls, hitmen and poets, all of whom have come to Bombay to make it. With a clear but non-judgmental voice, his is an outstanding tale of the exhilarating city in which he grew up.

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The Italian Boy: Murder and Grave-Robbery in 1830s London. By Sarah Wise. *Metropolitan Books; 400 pages; $26. Jonathan Cape; £17.99*

A gripping picture of the teeming underclass in Victorian London, told through the story of the investigation in 1831 into a series of fresh corpses supplied to the city's anatomy schools for dissection. The case that came to be known as "The Italian Boy" led to legislation that was to put an end in Britain to bodysnatching.

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Science and technology

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The Genome War: How Craig Venter Tried to Capture the Code of Life and Save the World. By Jim Shreeve. *Knopf; 416 pages; $26.95*

This is a model of how science writing should be done. A great portrait, and a fresh and surprising take on what you would think was a thoroughly picked-over story.

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The End of the Line: How Over-Fishing is Changing the World and What We Eat. By Charles Clover. *Ebury Press; 320 pages; £14.99*

For fishing, read “mining”, as global fish stocks are worked to exhaustion. Here is the world’s fishing industry laid bare, gutted and filleted for all to see: the greed, the folly, the waste and destruction. You will never look at a fish supper in the same way again.

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Jacquard’s Web: How a Hand Loom Led to the Birth of the Information Age. By James Essinger. *Oxford University Press; 302 pages; $28 and £14.99*

In 1804 Joseph-Marie Jacquard invented a hand loom that led the silk weavers of Lyons to produce their fabrics many times faster. The device made use of punchcards to store instructions for weavers. This book charts how the technology of the punchcard led, in fascinating ways, to prototype computers and even the information age.

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Backroom Boys: The Secret Return of the British Boffin. By Francis Spufford. *Faber and Faber; 240 pages; $27.42 and £14.99*

Britain, the country that invented the industrial revolution, has always had an ambivalent relationship with its engineers. Francis Spufford dissects this beautifully, with six post-war case studies that show how, with the one brilliant exception of Vodafone, neither the politicians, the bureaucrats, the businessmen nor even the engineers themselves actually got it quite right.

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Earth: An Intimate History. By Richard Fortey. *Knopf; 448 pages; $30. HarperCollins; £25*

Geology’s time in the scientific sun is long past, and its hard-won truths are now commonplace. Yet the latest work by Richard Fortey, at London’s Natural History Museum, is still imbued with the romantic, revolutionary spirit that drove his 19th-century forebears in their quest to turn, as it were, the world upside down.

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Politics and current affairs

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Plan of Attack. By Bob Woodward. *Simon & Schuster; 467 pages; $28 and £18.99*

In a fast-paced inside account of the Bush administration’s preparations to invade Iraq, Mr Woodward takes on the role both of instant historian and father confessor. Three decades after breaking the Watergate scandal, with Carl Bernstein, the author still has the power to depict the inner workings of the

White House. Not everybody, however, will feel comfortable with Mr Woodward's invented dialogue and generally unverifiable statements.

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Chain of Command: The Road from 9/11 to Abu Ghraib. By Seymour M. Hersh. *HarperCollins; 416 pages; $25.95. Penguin/Allen Lane; £17.99*

The latest book from a New Yorker staff writer and one of America's leading investigative reporters. In the kind of meticulous marshalling of facts and testimony from well-placed (though often also unnamed) sources that has become his trademark, Seymour Hersh offers a searing indictment of George Bush and his closest political aides for mishandling the war on terrorism, creating the conditions for the torture revealed at Abu Ghraib and ignoring or brushing aside facts that they do not like.

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The 9/11 Commission Report: Final Report of the National Commission on Terrorist Attacks Upon the United States. *Norton; 567 pages; $10 and £6.99*

A surprise bestseller of the year. Not only does the report provide an authoritative and well-written account of the terrorist attacks of September 11th, but it also offers wise words on the need for joined-up thinking in the West about how to win the war against radical Islamism.

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Surprise, Security, and the American Experience. By John Lewis Gaddis. *Harvard University Press; 150 pages; $18.95 and £12.95*

A masterclass by a distinguished cold-war historian. John Lewis Gaddis, at Yale University, sets September 11th and what followed in the context of the country's history, with criticisms of the Bush administration's very grand strategy, while being generally supportive of it. Outstandingly clear, the book is also blessedly short.

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American Dream: Three Women, Ten Kids, and a Nation's Drive to End Welfare. By Jason DeParle. *Viking; 432 pages; $25.95*

A former New York Times reporter follows three welfare mothers through the years after Bill Clinton's groundbreaking welfare reforms in 1996. It is a brilliant exercise that combines an honest but sensitive portrait of the women and their families with a larger look at the policy and the politics of welfare reform.

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Biography

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Ulysses S. Grant. By Josiah Bunting. Times Books; *208 pages; $20. Henry Holt; £11.99*

Even his critics concede that Ulysses Grant was a good general. This bold biography defies conventional history in arguing that, despite the inarguable troubles that marked his terms in office after the civil war, he was also a good president.

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The Architect King: George III and the Culture of the Enlightenment. By David Watkin. *The Royal Collection; 224 pages; £30. To be published in America by The Royal Collection in January*

George III had a passion for agricultural improvement, merino sheep and art, but architecture moved

him most of all. This book proves beyond doubt that, for all his periodic bouts of insanity, he was our most cultured king (along with Charles I, perhaps), and (along with Elizabeth I) England's most intelligent monarch.

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Alexander Hamilton. By Ron Chernow. *The Penguin Press; 818 pages; $35*

A work that restores the reputation of America's first treasury secretary, killed in a duel with the vice-president. Hamilton is usually maligned as arrogant and as having sold out to foreigners. Ron Chernow shows him to have been a visionary administrator and a patriot, who rose from his illegitimate beginnings through competence alone. Hamilton built the foundations for the American government and the financial system.

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Wodehouse: A Life. By Robert McCrum. *Norton; 530 pages; $27.95. Viking; £20*

A biography of the British comic writer who was dubbed "the Master" by his contemporaries. Mr McCrum skilfully plots the relationship between Wodehouse's three obsessions: writing, money and Pekinese dogs.

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Economics and business

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Why Globalisation Works. By Martin Wolf. *Yale University Press; 398 pages; $30 and £19.99*

The fullest and most sophisticated case yet for globalisation, by the chief economics commentator of the *Financial Times*. In plain, taut English, Martin Wolf argues that alleviating global poverty is the challenge of the age, and that the poorest countries in the world are poor not because of the baneful effects of too much globalisation, but rather because they stand outside the global economic system altogether. Mr Wolf pays a lot of attention to the interdependence of states and markets—and to the vital, even if limited, role that the state needs to play if countries are to prosper. The poorest countries, after all, are often failed states.

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Global Crises, Global Solutions. Edited by Bjorn Lomborg. *Cambridge University Press; 670 pages; $29.99 and £19.99*

A hugely sensible book about global health and environmental problems, based on the "Copenhagen Consensus" project documented in *The Economist*. Its authors, eminent economists, recognise that the resources to tackle such problems are finite and need to be applied where they are most likely to be effective. Better, for instance, to spend resources on the immediate problem of AIDS in Africa than the more distant one of global warming. This book is a healthy antidote to the narrow views of single-issue pressure groups.

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Mr China: A Wall Street Banker, an Englishman, an ex-Red Guard and $418,000,000 Disappearing Day by Day. By Tim Clissold. *Constable & Robinson; 304 pages; £9.99. To be published in America by HarperBusiness in February*

Every foreign company in China should arm its executives with a copy of this shocking, funny and culturally sympathetic tale of the perils of doing business in Asia's wild west. This first-hand account of one of the most expensive foreign forays into the Middle Kingdom is happily also one of the most instructive business books on China around. Next year the book will be translated into Chinese, for a market on mainland China that is hungry for business advice.

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The King of Sunlight: How William Lever Cleaned Up the World. By Adam Macqueen. *Bantam Press; 328 pages; £12.99. To be published in America by Corgi in June*

A book that takes the reader back to when soap was the silicon chip of the day. Less than four years after William Hesketh Lever opened his Sunlight soap factory in 1885, it was making 14,000 tons a week. This is a well-told story of Britain's greatest 19th-century brandmaker.

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The Modern Firm: Organisational Design for Performance and Growth. By John Roberts. *Oxford University Press; 318 pages; $27.50*

A professor of international business at Stanford University describes how businesses around the world are changing not just their processes and routines, but the very way they organise themselves and exercise authority. The consequences are profound. Yet among all this change, the author argues, certain predictable relationships improve productivity and performance.

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The Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits. By C.K. Prahalad. *Wharton School Publishing; 496 pages; $28.95. FT Prentice Hall; £19.99*

The best book on capitalism and the poor since Hernando de Soto's "The Mystery of Capital". It calls on big business to regard the world's poor as potential customers, and argues that both firms and the poor will win if it does. Plenty of entrepreneurial spirit and economic demand exist among the poor, and some of the world's leading firms are increasingly bent on working with them and on serving them.

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Innovation and Its Discontents: How Our Broken Patent System is Endangering Innovation and Progress, and What to Do About It. By Adam B. *Jaffe and Josh Lerner. Princeton University Press; 256 pages; $29.95*

A disturbing analysis of how the patent system, the heart of the knowledge economy, is rotten. With plenty of examples, the authors explain how America's patent system has become slow and bureaucratic, awarding too many patents for the wrong sorts of things. As a result, it is a threat to this most innovative economy.

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Other People's Money: The Corporate Mugging of America. By Nomi Prins. *The New Press; 336 pages; $26.95 and £17.95*

An insider's tale of how Wall Street went off the rails during the late 1990s. Nomi Prins details the pernicious effects of a failure properly to manage the conflicts of interest at the heart of the financial system. In the process, she provides the most revealing description yet of what it is like to work for the mighty Goldman Sachs, her employer during the stockmarket bubble.

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Culture and digressions

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Will in the World: How Shakespeare Became Shakespeare. By Stephen Greenblatt. *Norton; 434 pages; $26.95. Jonathan Cape; £20*

This historicist squeezes the most out of the few known facts about William Shakespeare. Unabashedly

speculative, he is acutely alive to the historical context, with an appetite for understanding the legalities of the time, the meanings of words, and the importance of friends and mentors.

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The Stories of English. By David Crystal. *Overlook Press; 584 pages; $35. Allen Lane; £25*

This superb general history of the language points out that the richness and diversity of English has always lain not in the standard form, but in its variation—regional, social and ethnic. Deserves to transform the way English is studied and taught.

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How to Be a Bad Birdwatcher. By Simon Barnes. *Short Books; 208 pages; £9.99. To be published in America by Pantheon in May*

By a sports writer for the *Times*, this is a gentle book, friendly, encouraging and in its way rather profound. Partly about birds, partly about how birdwatching changed the author's relationship with his father.

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Chronicles: Volume One. By Bob Dylan. *Simon & Schuster; 304 pages; $24 and £16.99*

It is the best of books, it is the worst of books. The first volume of Bob Dylan's projected autobiography begins and ends with a fascinating musician in a cold New York of the 1960s. The middle, however, drags with the musings of a self-important middle-aged man.

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Queen: The Life and Music of Dinah Washington. By Nadine Cohodas. *Pantheon Books; 576 pages; $28.50*

As Queen of the Blues, Dinah Washington brooked no rivals. Nadine Cohodas winningly captures the mixture of passion, talent and sheer wilfulness that characterised Washington's reign before her early death at the age of 39.

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Blood Horses: Notes of a Sportswriter's Son. By John Jeremiah Sullivan. *Farrar, Straus and Giroux; 272 pages; $24*

An eloquent and strange account of the history of man's relationship with the horse, interleaved with a personal narrative that is touching and funny.

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A Little History of British Gardening. By Jenny Uglow. *North Point Press; 256 pages; $35. Chatto & Windus; £15.99*

An addictive book that attempts to answer why the British are so potty about gardening. The argument, worn lightly, is that gardening is an expression of Britishness.

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Books by *Economist* writers in 2004

Write books

Nov 25th 2004

Is what some of us do outside office hours

OUR policy is not to review books by staff or by regular contributors, because of the difficulty of convincing readers that such reviews are independent. Yet some readers have asked to know about our books. So here is our annual list of books published by staff and regular freelance contributors during 2004. The list will be kept up to date here (which also has details of all staff books in print).

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Chekhov: Scenes from a Life. By Rosamund Bartlett. *Free Press; 432 pages; £20*

An impressionistic approach to Chekhov's life, by one of our reviewers, a specialist on Russian literature. The book focuses on Chekhov's relationship to the landscapes in which he lived and travelled.

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In the Rose Garden of the Martyrs: A Memoir of Iran. By Christopher de Bellaigue. *HarperCollins; 304 pages; £20. To be published in America by HarperCollins in January*

A portrait of an enigmatic nation of wistful revolutionaries, with a long shadow still cast by the 1979 Islamic revolution. Written by our Tehran correspondent.

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Essential Economics. By Matthew Bishop. *Bloomberg/Economist Books; 256 pages; $15. Profile Books/Economist Books; £10.99*

A guide to economics for non-economists, with clear explanations of hundreds of economic concepts from absolute advantage to zero-sum game, by our Business editor.

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The Shackled Continent: Power, Corruption, and African Lives. By Robert Guest. *Smithsonian Books; 288 pages; $27.50. Macmillan; £20*

Why is Africa so poor? Our Africa editor lays most of the blame on predatory and incompetent African governments. The analysis is brought to life with examples from slums, markets, war zones and the passenger seat of a Cameroonian beer truck.

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Midnight in Some Burning Town: British Special Forces Operations from Belgrade to Baghdad. By Christian Jennings. *Weidenfeld & Nicolson; 256 pages; £18.99*

A colourful insight into SAS missions in Kosovo, Afghanistan and Iraq, with an analysis that puts them in the context of the past decade's interventions by the international community in the Balkans, Africa, Central Asia and the Middle East. By one of our reviewers.

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Berlusconi's Shadow: Crime, Justice and the Pursuit of Power. By David Lane. *Penguin/Allen Lane; 353 pages; £18.99*

Our Italian business correspondent delves into the life and career of Silvio Berlusconi and his wealth and offshore companies, his shadowy business associates, his links with Mafia and right-wing figures, his manipulation of the legal system, and the staggering conflicts of interest that come with his money and media holdings.

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Where We Have Hope: A Memoir of Zimbabwe. By Andrew Meldrum. *John Murray; 288 pages; £17.99*

A memoir of 23 years in Zimbabwe, by our former correspondent there. Part adventure, part travel, it is a coming-of-age story of a young journalist as well as a country. The chronicle focuses on the brave people demanding a return to democracy.

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The Right Nation: Conservative Power in America. By John Micklethwait and Adrian Wooldridge. *The Penguin Press; 400 pages; $25.95. Penguin/Allen Lane; £14.99*

A portrait of conservative America, by our American editor and Lexington columnist. It traces the story of how a creed which only 50 years ago was seen as an eccentric sect has now become the dominant ideology and political power in the world's most powerful country.

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Soweto Inside Out: Stories About Africa's Famous Township. Edited by Adam Roberts and Joe Thloloe. *Penguin Books; 239 pages; 95 rand*

A volume on Soweto, the century-old black township south-west of Johannesburg where much of South Africa's political history has been played out. Contributions are from local and foreign writers and are edited by our South Africa correspondent and by a true Sowetan veteran.

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Obituary

Iris Chang

Nov 25th 2004
From The Economist print edition

Corbis

Iris Chang, chronicler of a massacre, died on November 9th, aged 36

AMONG the many issues that bedevil relations between China and Japan, the most intractable occurred almost 70 years ago. In 1937 around 50,000 Japanese troops descended on Nanking, China's former capital, and took charge there. What happened next is a matter of lasting controversy. The Chinese say that more than 300,000 civilians were killed, and 80,000 girls and women raped. The Japanese divide into different schools of thought. At one extreme, the “Great Illusion” school argues that almost no civilians were killed, and that most of the deaths were legal killings of soldiers in plain clothes. At the other, the “Great Massacre” school thinks as many as 200,000 Chinese may have died. Scholars on both sides continue to revile each other either as Japan-bashers, or as apologists for imperialism.

In Japan, the Nanking “Incident”—still too controversial even to have a settled name—is central to a wider debate about history teaching in Japanese schools. In China, it is crucial to the nation's modern identity. After the war, the atrocity was played down: Japan, seared by Hiroshima and Nagasaki, was seen as a victim nation, not as an aggressor, and the Americans were keen to cultivate it as a counterweight to dangerous Red China. To deny the Chinese version of Nanking, therefore, is to continue to gang up on China and to stifle its account of history.

Into this maelstrom of nationalist pride and pain stepped, in the 1990s, a 29-year-old Chinese-American. Iris Chang was not an historian by training. She had studied journalism at the University of Illinois, then taken a master's in science writing, and had worked for a while on the *Chicago Tribune*. Her interest in Nanking was aroused incidentally, by hearing her grandparents talk about it. Like many others, they had fled the city before the Japanese arrived; what they knew was hearsay. But it was sufficiently terrible for Miss Chang to spend a day “walking around in a state of shock”, before deciding to devote herself to making the massacre known.

For two years she did research in China, rifling the archives and talking to survivors. She pinned a map of Nanking on her study wall, covering it with pictures of tortures and killing in the places where they had happened. Some civilians had been mutilated with broken beer bottles, some impaled on bamboo. Women's breasts had been cut off and nailed to walls. The Japanese killed so many men that they found it quicker to bayonet them as they stood in a line, rather than behead them.

As the grim stories accumulated, Miss Chang lost weight and broke down. She went on, defying

exhaustion. When her book on Nanking came out, in 1997, she spent a year on the road talking about it. More than half a million copies were sold in America alone; she became a celebrity, leaving audiences astonished that this pretty, smiling girl could tell such tales of horror. But she did not care, she said, whether she made a cent from it. All she wanted to do was get the story out.

Facing the ambassador

“Proper” historians cavilled, and with some reason. Her book, several said, was too polemical, and was riddled with mistakes which she refused to correct. Her reliance on oral history, especially the fading memories of Chinese witnesses, was unwise. Even her use of the invaluable diaries of foreign “bystanders” in Nanking was suspect, for these people—who had organised a “safety zone” both for foreigners and Chinese—had no idea of the actual numbers killed. When her book was translated into Japanese, supporters of the Great Massacre school found they could not defend her figures, which were higher even than those claimed in China.

Miss Chang could not bear this nit-picking. A great injustice had occurred, and had been all but covered up. There was no doubt at all that it had happened, with immense human suffering. She had no time for semantics: whether to include deaths outside the city walls, whether the plain-clothes soldiers had been billeted with civilians, and so on. What she wanted, at the very least, was an official Japanese apology. Face to face on television with the Japanese ambassador to America, she demanded one. When he muttered that there had been “perhaps some unfortunate incidents”, she was outraged.

When she died—apparently by shooting herself in the head, on a rural road in California—she had started work on a book on the Bataan Death March and the abuse of American prisoners-of-war by the Japanese. Again, the stories were affecting her: she had been taken to hospital, suffering from depression.

She had been planning, too, to publish the diaries of Minnie Vautrin, an American missionary in Nanking during the massacre. Vautrin, like her, came from Illinois. She had saved thousands of Chinese civilians from the Japanese, sometimes giving them her own last ration of rice. In 1941, however, a year to the day after leaving Nanking, she had committed suicide, convinced that she had done too little.

Friends wondered whether Miss Chang had felt the same. This was certainly likely. But she was also aware that her writings had played into the hands of the massacre's deniers: that she had perhaps not only done too little, but protested too much.

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Overview

Nov 25th 2004
From The Economist print edition

The **dollar** fell to a new low against the euro in the days after Alan Greenspan, chairman of America's Federal Reserve, described America's current-account deficit as “increasingly less tenable”. Russia's statement that it might reduce the share of its foreign-currency reserves held in dollars sent the greenback into a further slump, and the euro rose above $1.31 for the first time in the history of the single currency. **Sterling** rose to a five-month high against the dollar of $1.88.

Bond markets seemed to take the dollar's decline in stride. The yield on America's ten-year bond rose only slightly to 4.20%. **Gold** continued its climb and reached a 16-year high just short of $450 an ounce. The price of a barrel of West Texas Intermediate crude **oil** rose to $49.

Consumer confidence in America fell at the end of November from its level earlier in the month, according to the University of Michigan's survey.

America's **housing market** remains strong. Sales of existing homes fell in October by only 0.1% to 6.75 million at an annualised rate. The median sales price rose by 0.7% the same month, and sales of new homes were above expectations.

The **euro area's** economic slowdown was confirmed by another statistic. According to EuroCOIN, an economic indicator published by Britain's Centre for Economic Policy Research, growth in the euro area slowed further in October. The indicator's level fell to 0.479 during the month, down from 0.485 in September. A year ago, the indicator gave a reading of 0.713.

France's GDP growth for the year to the third quarter was revised down to 2.0% from 2.1% in the previous estimate.

Unemployment in **Sweden** fell to 4.9% in October from 5.8% in September. A year ago, the unemployment rate was 5.1%.

Canada's consumer prices rose by 0.2% in October. For the year to October, the CPI rose by 2.3%, up from a rise of 1.8% in the year to September. The Bank of Canada's measure of core inflation, which excludes the most volatile consumer prices, fell to 1.4% in the year to October, down from 1.5% in the year to September.

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Output, demand and jobs

Nov 25th 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 4.1	Q2	+ 2.5	+ 3.6	+ 3.2	+ 4.6	Q2	+ 5.7	Q3	5.3	Oct	5.9
Austria	+ 1.8	Q2	+ 3.5	+ 1.6	+ 2.1	+ 9.5	Aug	+ 3.2	Aug	4.5	Oct	4.6
Belgium	+ 3.0	Q3	+ 3.2	+ 2.4	+ 2.1	+ 0.9	Sep	+ 0.9	Aug	13.2	Oct†	12.9
Britain	+ 3.0	Q3	+ 1.5	+ 3.2	+ 2.5	– 0.9	Sep	+ 6.0	Oct	4.6	Sep††	5.0
Canada	+ 3.0	Q2	+ 4.3	+ 3.0	+ 3.3	+ 6.4	Aug	+ 2.4	Jul	7.1	Oct	7.6
Denmark	+ 2.6	Q2	+ 1.0	+ 2.3	+ 2.3	– 2.6	Sep	+ 4.2	Sep	6.3	Sep	6.3
France	+ 2.0	Q3	+ 0.3	+ 2.4	+ 2.2	+ 2.9	Sep	+ 1.0	Aug	9.9	Sep	9.9
Germany	+ 1.3	Q3	+ 0.4	+ 1.5	+ 1.6	+ 2.5	Sep	– 1.4	Sep	10.7	Oct§	10.5
Italy	+ 1.3	Q3	+ 1.7	+ 1.1	+ 1.6	+ 0.8	Sep	– 4.0	Aug	8.1	Apr	8.7
Japan	+ 3.9	Q3	+ 0.3	+ 4.3	+ 2.1	+ 3.8	Sep	– 0.4	Sep	4.6	Sep	5.1
Netherlands	+ 1.4	Q3	+ 0.8	+ 1.2	+ 1.6	– 0.6	Sep	– 0.1	Aug	6.3	Oct**	5.4
Spain	+ 2.6	Q3	+ 2.4	+ 2.6	+ 2.5	+ 3.9	Sep	+ 0.2	Sep	10.6	Sep	11.3
Sweden	+ 3.6	Q2	+ 4.0	+ 3.4	+ 2.9	+ 5.3	Sep	+ 5.2	Sep	4.9	Oct†	5.1
Switzerland	+ 2.0	Q2	+ 1.6	+ 1.8	+ 2.0	+ 4.3	Q2	– 0.3	Sep	3.7	Oct†	3.8
United States	+ 3.9	Q3	+ 3.7	+ 4.4	+ 3.4	+ 5.2	Oct	+ 6.3	Sep	5.5	Oct	6.0
Euro area	+ 1.9	Q3	+ 1.2	+ 1.8	+ 1.9	+ 2.9	Sep	nil	Sep	8.9	Sep	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.7	Q2	+ 2.9	na	na	+ 5.1	Sep	+ 4.9	Sep	8.0	Oct†	8.3
Greece	+ 3.9	Q2	– 0.6	na	na	+ 0.8	Sep	+ 6.6	Jul	na		na
Iceland	+ 6.2	Q2	na	na	na	na		na		2.6	Sep†	2.7
Ireland	+ 4.1	Q2	na	na	na	+ 5.2	Sep	+ 3.2	Sep	4.4	Oct	4.6
Luxembourg	+ 2.1	2003	na	na	na	– 1.2	Dec	– 8.2	Sep	4.2	Sep	3.8
New Zealand	+ 6.0	Q2	+ 4.6	na	na	+ 5.5	Q2	+ 7.4	Q3	3.8	Q3	4.4
Norway	+ 4.1	Q2	+ 5.0	na	na	– 3.3	Sep	+ 2.0	Sep	3.7	Oct‡	3.8
Portugal	+ 1.5	Q2	+ 4.7	na	na	– 3.6	Sep	+ 3.6	Sep	6.8	Q3†	6.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Jul-Sep; claimant count rate 2.7% in Oct. §EU harmonised rate 9.9% in Oct. **Aug-Oct.

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Prices and wages

Nov 25th 2004
From The Economist print edition

% change on year ago

	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2004	2005	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 2.3	Q3	+ 2.6	+ 2.5	+ 2.7	+ 6.1	Q3	– 0.1	+ 3.7	Q3	+ 5.1
Austria	+ 2.6	Oct	+ 1.0	+ 1.7	+ 1.6	+ 6.0	Oct	+ 2.0	+ 2.0	Sep	+ 2.3
Belgium	+ 2.9	Oct	+ 1.6	+ 2.0	+ 1.8	+ 6.0	Oct	– 1.0	+ 2.2	Jul	+ 1.9
Britain	+ 1.2	Oct*	+ 1.4	+ 1.4	+ 1.7	+ 3.5	Oct	+ 1.5	+ 3.7	Sep†	+ 3.6
Canada	+ 2.3	Oct	+ 1.6	+ 2.0	+ 2.2	+ 4.6	Sep	– 2.7	+ 2.2	Aug	+ 3.5
Denmark	+ 1.7	Oct	+ 1.4	+ 1.2	+ 1.8	+ 3.6	Oct	nil	+ 2.9	Q3	+ 3.7
France	+ 2.1	Oct	+ 2.2	+ 2.3	+ 1.7	+ 3.1	Sep	+ 0.1	+ 2.7	Q3	+ 2.9
Germany	+ 2.0	Oct	+ 1.2	+ 1.8	+ 1.4	+ 4.2	Oct	+ 0.6	+ 0.9	Sep	+ 2.6
Italy	+ 2.0	Oct	+ 2.6	+ 2.3	+ 2.1	+ 3.9	Sep	+ 1.0	+ 2.5	Sep	+ 2.7
Japan	nil	Sep	– 0.2	– 0.1	+ 0.1	+ 1.9	Oct	– 0.5	+ 0.7	Sep	+ 1.5
Netherlands	+ 1.4	Oct	+ 2.0	+ 1.4	+ 1.3	+ 6.0	Sep	– 0.3	+ 1.1	Oct	+ 2.3
Spain	+ 3.6	Oct	+ 2.7	+ 2.9	+ 2.8	+ 5.4	Oct	+ 0.6	+ 3.1	Q2	+ 4.2
Sweden	+ 0.8	Oct	+ 1.4	+ 0.7	+ 1.6	+ 3.0	Oct	– 1.9	+ 2.2	Aug	+ 3.3
Switzerland	+ 1.3	Oct	+ 0.5	+ 0.7	+ 1.1	+ 2.0	Oct	– 0.3	+ 1.4	2003	+ 1.8
United States	+ 3.2	Oct	+ 2.0	+ 2.6	+ 2.3	+ 4.4	Oct	+ 3.9	+ 2.6	Oct	+ 2.2
Euro area	+ 2.4	Oct	+ 2.0	+ 2.1	+ 1.8	+ 3.4	Sep	+ 1.1	+ 2.1	Q2	+ 3.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.9	Oct	+ 0.3	na	na	+ 3.0	Oct	– 0.9	+ 3.5	Q2	+ 4.4
Greece	+ 3.2	Oct	+ 3.2	na	na	+ 2.7	Sep	+ 1.5	na		na
Iceland	+ 3.8	Nov	+ 2.5	na	na	+ 6.1	Nov	+ 3.3	+ 5.3	Oct	+ 5.5
Ireland	+ 2.7	Oct	+ 2.3	na	na	– 0.8	Sep	– 7.8	+ 3.8	Q2	+ 8.0
Luxembourg	+ 2.5	Oct	+ 1.7	na	na	+15.0	Sep	+ 0.5	– 0.4	Dec	+ 0.7
New Zealand	+ 2.5	Q3	+ 1.5	na	na	+ 2.5	Q3	+ 0.1	+ 2.2	Q3	+ 2.3
Norway	+ 1.4	Oct	+ 1.6	na	na	+24.1	Oct	+ 2.1	+ 4.5	Q2	+ 5.4
Portugal	+ 2.1	Oct	+ 3.0	na	na	+ 5.2	Oct	– 0.8	+ 1.4	Sep	– 1.8

*New series. RPI inflation rate in October: 3.3%. †Jul-Sep.

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Older citizens

Nov 25th 2004
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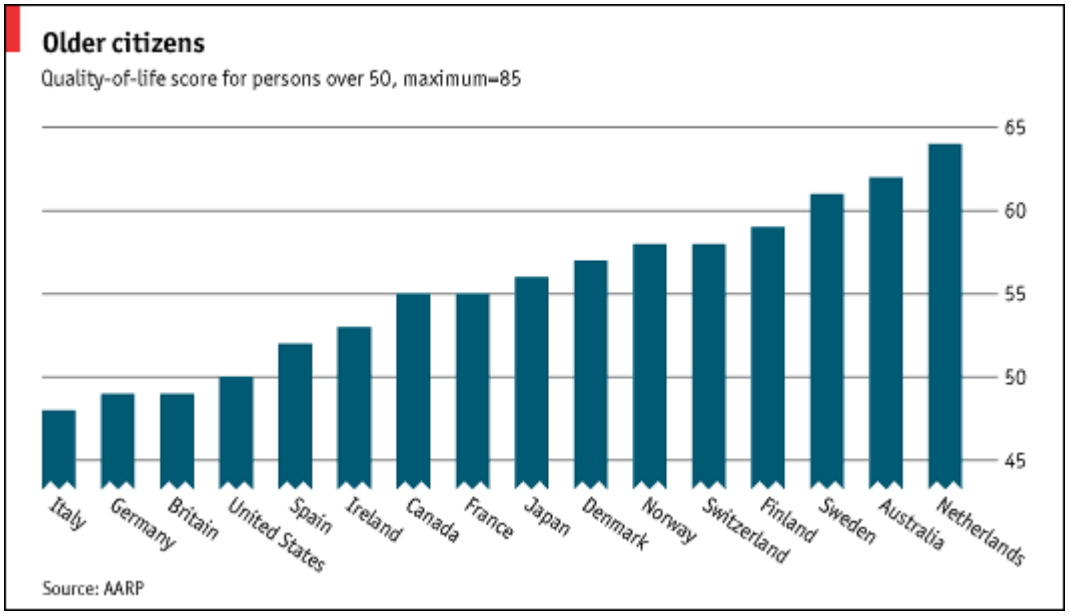

The Netherlands looks after its old folks better than any other country surveyed by AARP, an American association for over-50s. The survey takes note of policies that are of special interest to the elderly, such as age-discrimination laws, mandatory retirement ages and health-care coverage. Germany's score reflects below-average rankings in age-discrimination laws and public-pension benefits.

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Money and interest rates

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From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Nov 24th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 4.2	+ 9.7	Sep	5.44	5.31	5.01	5.38	5.93	6.28
Britain	+ 5.8	+ 9.3	Sep	4.81	3.91	4.47	4.61	5.04	5.26
Canada	+ 9.6	+ 9.1	Sep	2.66	2.73	3.14	4.43	4.98	5.93
Denmark	+ 9.8	+10.7	Sep	2.25	2.30	2.47	3.77	4.58	5.28
Japan	+ 4.3	+ 2.1	Oct	0.03	0.02	0.10	1.42	1.37	1.60
Sweden	+ 1.6	+ 3.1	Sep	2.03	2.73	2.50	4.01	4.98	2.66
Switzerland	– 2.0	+ 0.6	Sep	0.75	0.27	1.10	2.35	2.80	2.40
United States	+ 5.0	+ 4.8	Sep	2.23	1.30	3.00	4.20	4.41	5.69
Euro area†	+ 9.7	+ 6.0	Sep	2.17	2.17	2.35	3.70	4.42	3.68

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.96%, Japan No. 264 1.48%. Central bank rates: US fed funds 2.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Nov 25th 2004
From The Economist print edition

1995=100

	Nov 16th*	Nov 23rd*	% change on one month	% change on one year
Dollar index				
All items	88.4	88.6	+ 3.0	+ 2.4
Food	81.3	81.4	+ 1.7	– 5.3
Industrials				
All	98.1	98.4	+ 4.4	+12.6
Nfa†	82.2	82.1	+ 0.6	– 8.7
Metals	111.5	112.2	+ 6.9	+31.5
Sterling index				
All items	75.2	74.7	+ 1.1	– 7.1
Euro index				
All items	89.6	89.0	+ 0.5	– 7.8
Yen index				
All items	99.1	97.4	– 0.1	– 3.5
Gold				
$ per oz	439.83	448.43	+ 5.3	+14.3
West Texas Intermediate				
$ per barrel	46.06	48.79	–11.6	+64.0

* Provisional. † Non-food agriculturals.

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Stockmarkets

Nov 25th 2004
From The Economist print edition

Market indices

	Nov 24th	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,894.7	3,894.7	3,274.9	+ 0.1	nil	+17.8	+23.2
Austria (ATX)	2,265.8	2,265.8	1,568.9	+ 2.2	nil	+46.6	+53.0
Belgium (Bel 20)	2,872.3	2,872.3	2,244.2	+ 1.1	-22.0	+28.0	+33.6
Britain (FTSE 100)	4,719.4	4,805.3	4,287.0	- 1.6	-31.9	+ 5.4	+10.7
Canada (Toronto Composite)	8,976.1	8,995.2	8,123.5	- 0.1	-21.2	+ 9.2	+19.5
Denmark (KBX)	255.9	255.9	219.0	+ 1.4	-15.2	+19.8	+25.3
France (SBF 250)	2,578.1	2,623.3	2,386.1	- 1.7	-41.3	+ 6.9	+11.6
(CAC 40)	3,760.7	3,844.1	3,465.3	- 2.2	-45.7	+ 5.7	+10.3
Germany (DAX)	4,125.3	4,183.4	3,647.0	- 1.4	-48.8	+ 4.0	+ 8.6
Italy (BCI)	1,404.0	1,415.8	1,239.5	+ 0.1	-35.7	+11.7	+16.6
Japan (Nikkei 225)	10,872.3	12,163.9	10,365.4	- 2.3	-72.1	+ 1.8	+ 6.1
(Topix)	1,090.9	1,217.9	1,022.6	- 2.1	-62.2	+ 4.5	+ 9.0
Netherlands (AEX)	337.3	364.8	310.7	- 1.4	-51.9	- 0.1	+ 4.2
Spain (Madrid SE)	916.1	916.1	804.4	+ 0.7	-20.1	+13.4	+18.3
Sweden (Affarsvarlden Gen)	218.2	220.6	188.5	- 1.1	-45.5	+15.8	+22.9
Switzerland (Swiss Market)	5,501.2	5,934.4	5,309.7	- 3.2	-34.6	+ 0.2	+ 7.8
United States (DJIA)	10,520.3	10,737.7	9,750.0	- 0.3	-10.3	+ 0.6	+ 0.6
(S&P 500)	1,181.8	1,184.2	1,063.2	nil	-22.6	+ 6.3	+ 6.3
(NASDAQ Comp)	2,102.5	2,153.8	1,752.5	+ 0.1	-58.4	+ 5.0	+ 5.0
Europe (FTSE Eurotop 300)*	1,022.9	1,037.4	940.9	- 1.4	-40.0	+ 6.8	+11.4
Euro area (FTSE Ebloc 100)*	876.5	888.3	787.2	- 1.3	-43.5	+ 5.4	+10.0
World (MSCI)†	1,127.1	1,128.2	997.0	- 0.1	-22.2	+ 8.8	+ 8.8
World bond market (Citigroup)‡	652.4	652.4	575.1	+ 1.1	nil	+ 8.1	+ 8.1

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Nov 25th 2004
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	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2004	2005	Exchange rate trade-weighted† 1990=100 Nov 24th	year ago	Currency units per $ Nov 24th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2004‡
Australia	− 17.0	Sep	− 34.2	Q2	− 5.8	− 5.3	88.6	86.5	1.27	1.38	2.39	1.67	1.23	+ 0.5
Austria	− 0.1	Sep	− 1.1	Sep	− 0.3	− 0.4	103.1§	102.6	0.76	0.84	1.43	–	0.74	− 1.3
Belgium	+ 20.5	Sep	+ 13.0	Jun	+ 3.3	+ 3.2	103.3§	102.7	0.76	0.84	1.43	–	0.74	− 0.2
Britain	−101.1	Sep	− 41.7	Q2	− 2.5	− 2.7	101.7	100.2	0.53	0.59	–	0.70	0.52	− 2.9
Canada	+ 50.2	Sep	+ 23.8	Q2	+ 2.8	+ 2.5	96.6	88.9	1.18	1.30	2.22	1.55	1.15	+ 1.2
Denmark	+ 9.8	Sep	+ 6.5	Sep	+ 2.9	+ 2.6	107.0	106.2	5.65	6.24	10.6	7.43	5.49	+ 0.9
France	− 2.8	Sep	− 2.3	Sep	+ 0.3	+ 0.3	106.8§	106.0	0.76	0.84	1.43	–	0.74	− 3.8
Germany	+186.4	Sep	+ 90.2	Sep	+ 3.2	+ 2.9	104.5§	103.5	0.76	0.84	1.43	–	0.74	− 3.7
Italy	+ 2.4	Sep	− 12.6	Sep	− 0.9	− 1.1	76.2§	75.5	0.76	0.84	1.43	–	0.74	− 3.1
Japan	+130.9	Oct	+169.0	Sep	+ 3.5	+ 3.5	138.3	136.5	103	109	193	135	–	− 7.1
Netherlands	+ 35.0	Sep	+ 21.0	Q3	+ 2.9	+ 3.0	102.8§	102.1	0.76	0.84	1.43	–	0.74	− 3.1
Spain	− 66.3	Aug	− 38.5	Aug	− 3.4	− 3.6	77.3§	76.9	0.76	0.84	1.43	–	0.74	+ 0.3
Sweden	+ 22.8	Oct	+ 26.2	Q3	+ 7.0	+ 6.4	84.1	82.0	6.78	7.57	12.8	8.93	6.60	+ 0.2
Switzerland	+ 7.9	Oct	+ 45.0	Q2	+11.3	+10.8	115.8	111.8	1.15	1.30	2.16	1.51	1.12	− 1.6
United States	−621.1	Sep	−571.9	Q2	− 5.5	− 5.4	89.4	97.6	–	–	1.88	1.32	0.97	− 4.7
Euro area	+100.1	Sep	+ 55.1	Sep	+ 0.6	+ 0.6	93.0	90.4	0.76	0.84	1.43	–	0.74	− 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 14.6	Sep	+ 8.6	Sep	na	na	82.2§	81.5	0.76	0.84	1.43	–	0.74	+ 1.6
Greece	− 30.1	Sep	− 10.3	Sep	na	na	59.7§	59.3	0.76	0.84	1.43	–	0.74	− 3.2
Iceland	− 0.4	Sep	− 0.6	Q2	na	na	96.1**	95.0	66.1	75.2	124	87.0	64.3	+ 0.2
Ireland	+ 42.5	Aug	− 1.7	Q2	na	na	94.8§	94.2	0.76	0.84	1.43	–	0.74	− 0.5
Luxembourg	− 4.3	Aug	+ 2.1	Q2	na	na	103.3§	102.7	0.76	0.84	1.43	–	0.74	− 1.8
New Zealand	− 2.6	Sep	− 3.9	Q2	na	na	107.1	102.8	1.41	1.56	2.66	1.86	1.37	+ 2.9
Norway	+ 32.5	Oct	+ 31.7	Aug	na	na	99.5	98.4	6.18	6.85	11.6	8.13	6.01	+ 10.4
Portugal	− 16.9	Aug	− 11.6	Sep	na	na	93.6**	93.6	0.76	0.84	1.43	–	0.74	− 3.8

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, September average. ‡OECD forecast. **IMF, July average.

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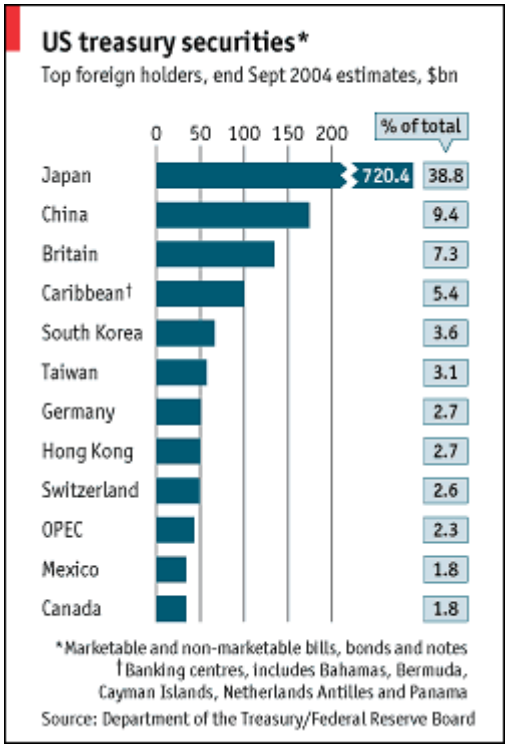
US treasury securities

Nov 25th 2004
From The Economist print edition



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Overview

Nov 25th 2004
From The Economist print edition

South Korea's GDP growth slowed to 4.6% in the year to the third quarter, down from 5.5% in the year to the second quarter. **Taiwan's** economic growth also cooled in the year to the third quarter to a rate of 5.3%.

Industrial-production growth in **Poland** slowed to 3.3% in the year to October.

Chile's economy grew by 6.8% in the year to the third quarter.

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Czech Republic

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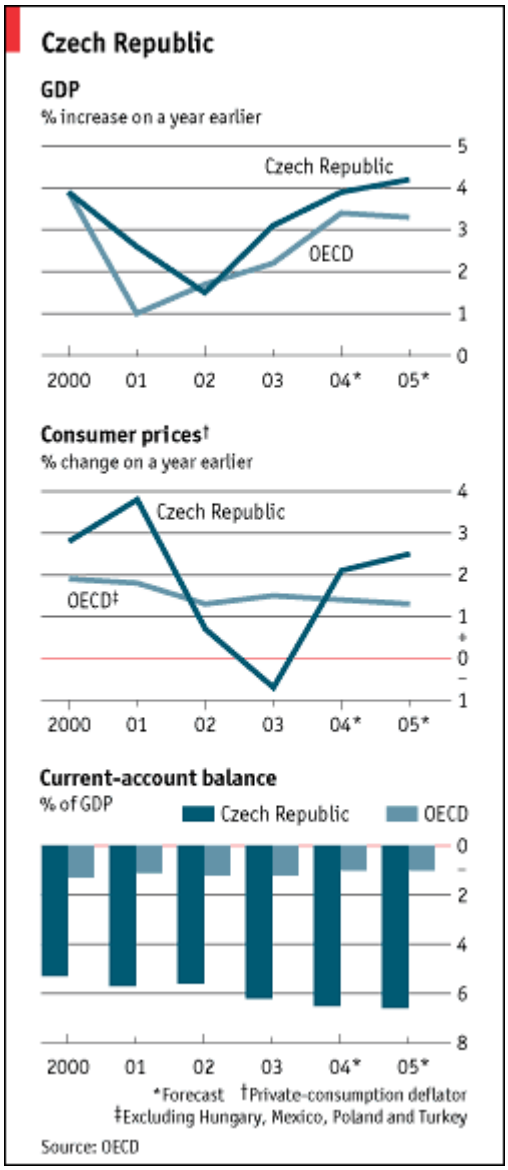
The Czech Republic's economy grew at a healthy pace last year. The OECD, in its latest report on the country, forecasts GDP growth of 3.9% in 2004 and 4.2% in 2005, both above the country's long-run trend rate. Consumer-price inflation is expected to remain on average below 3% through the end of 2005. The current-account deficit, however, remains one of the world's highest at 6.2% of GDP last year. The economy faces other challenges. Government spending is rising, creating a big budget deficit and the need for higher taxes. The country must also make its labour market more flexible and ease the burdens on businesses, reckons the OECD.



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Economy

Nov 25th 2004
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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.1	Q3	+15.7	Oct	+ 4.3	Oct	+21.6	Oct	+45.9	2003	514.5	Sep
Hong Kong	+12.1	Q2	+ 1.1	Q2	+ 0.2	Oct	−13.8	Sep	+13.6	Q2	119.5	Oct
India	+ 7.4	Q2	+ 7.7	Sep	+ 4.8	Sep	−20.3	Oct	+11.0	Q2	115.7	Oct
Indonesia	+ 4.3	Q2	− 2.3	Aug	+ 6.2	Oct	+25.4	Sep	+ 3.9	Q2	33.6	Sep
Malaysia	+ 8.0	Q2	+ 9.8	Sep	+ 2.1	Oct	+21.1	Sep	+13.6	Q2	56.0	Sep
Philippines	+ 6.2	Q2	+ 7.2	Sep	+ 7.1	Oct	− 1.2	Sep	+ 4.5	Jun	12.6	Oct
Singapore	+ 7.5	Q3	+11.8	Sep	+ 1.9	Oct	+15.6	Oct	+29.0	Q3	105.8	Oct
South Korea	+ 4.6	Q3	+ 9.3	Sep	+ 3.8	Oct	+29.1	Oct	+28.0	Sep	178.3	Oct
Taiwan	+ 5.3	Q3	+ 2.9	Oct	+ 2.4	Oct	+ 9.0	Oct	+24.8	Q3	235.0	Oct
Thailand	+ 6.3	Q2	+ 7.7	Sep	+ 3.5	Oct	+ 1.1	Sep	+ 6.7	Sep	43.7	Sep
Argentina	+ 7.0	Q2	+ 5.2	Oct	+ 5.6	Oct	+12.6	Sep	+ 4.6	Q2	18.6	Oct
Brazil	+ 5.7	Q2	+ 7.6	Sep	+ 6.9	Oct	+32.6	Oct	+ 9.8	Sep	49.5	Sep
Chile	+ 6.8	Q3	+12.0	Sep	+ 1.9	Oct	+ 7.9	Oct	+ 2.0	Q3	15.7	Oct
Colombia	+ 4.3	Q2	+ 8.9	Aug	+ 5.9	Oct	+ 0.4	Aug	− 1.6	Q2	12.1	Oct
Mexico	+ 4.4	Q3	+ 5.5	Sep	+ 5.4	Oct	− 5.9	Oct	− 5.5	Q3	62.2	Sep
Peru	+ 4.5	Sep	+ 4.0	Sep	+ 4.0	Oct	+ 2.2	Sep	− 0.3	Q3	11.4	Oct
Venezuela	+15.8	Q3	+19.7	Aug	+19.7	Oct	+21.5	Q3	+14.4	Q3	16.1	Aug
Egypt	+ 4.3	2004†	+ 2.3	2003†	+10.7	Aug‡	− 7.5	Q2	+ 3.7	Q2	13.2	Jul
Israel	+ 3.4	Q3	+ 2.5	Sep	+ 0.8	Oct	− 6.5	Oct	+ 0.1	Q2	26.1	Oct
South Africa	+ 2.5	Q2	+ 6.1	Sep	+ 2.4	Oct	− 1.1	Sep	− 3.5	Q2	11.3	Oct
Turkey	+13.4	Q2	+ 5.4	Sep	+ 9.9	Oct	−32.1	Sep	−14.0	Sep	34.7	Sep
Czech Republic	+ 4.1	Q2	+ 6.6	Sep	+ 3.5	Oct	− 1.8	Sep	− 6.2	Q2	27.1	Oct
Hungary	+ 4.0	Q2	+ 6.7	Sep	+ 6.3	Oct	− 3.0	Q2	− 8.4	Q2	14.5	Oct
Poland	+ 6.1	Q2	+ 3.3	Oct	+ 4.5	Oct	− 5.1	Aug	− 3.0	Aug	35.3	Sep
Russia	+ 7.4	Q2	+ 3.5	Oct	+11.5	Oct	+78.6	Sep	+44.6	Q3	103.6	Oct
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 5.9	Q2	+ 6.3	Oct	+ 4.5	Oct	− 2.5	Sep	− 1.5	Q2	1.5	Sep
Latvia	+ 7.7	Q2	+ 3.3	Sep	+ 7.2	Oct	− 1.5	Sep	− 1.5	Sep	1.7	Sep
Lithuania	+ 6.0	Q3	na		+ 3.3	Oct	− 3.1	Sep	− 1.8	Q2	3.3	Sep
Slovakia	+ 5.4	Q2	+ 5.0	Sep	+ 6.6	Oct	− 1.1	Sep	− 1.0	Aug	12.8	Sep
Slovenia	+ 4.6	Q2	+ 3.9	Sep	+ 3.3	Oct	− 1.0	Sep	− 0.8	Sep	7.8	Aug
Pakistan	+ 6.4	2004†	+27.0	Jun	+ 8.7	Oct	− 4.3	Oct	+ 0.8	Q3	10.8	Sep
Saudi Arabia	+ 7.2	2003	na		nil	Sep	+59.1	2003	+28.0	2003	22.3	Sep

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series, % change Jan-Aug annualised.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Nov 25th 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Nov 24th		Dec 31st 2003	
	Nov 24th	year ago	Nov 24th	% a year		one week	in local currency	in $ terms
China	8.28	8.28	15.6	2.75	1,426.9	+0.2	– 9.1	– 9.1
Hong Kong	7.77	7.77	14.6	0.25	13,997.0	+1.2	+ 11.3	+ 11.1
India	45.0	45.9	84.7	5.35	6,036.0	+0.3	+ 3.4	+ 4.8
Indonesia	8,975	8,517	16,877	7.49	961.3	+2.9	+ 38.9	+ 30.4
Malaysia	3.80	3.80	7.15	2.84	910.9	+1.0	+ 14.7	+ 14.7
Philippines	56.3	55.5	105.9	7.19	1,826.2	+1.8	+ 26.6	+ 24.8
Singapore	1.64	1.72	3.09	1.38	2,040.2	–0.3	+ 15.6	+ 19.6
South Korea	1,067	1,203	2,006	3.36	872.6	–1.5	+ 7.6	+ 20.2
Taiwan	32.3	34.1	60.7	1.25	5,911.3	–1.9	+ 0.4	+ 5.6
Thailand	39.7	39.9	74.6	2.15	643.1	–0.2	– 16.7	– 16.8
Argentina	2.94	2.95	5.52	5.19	1,182.2	–6.3	+ 10.3	+ 10.1
Brazil	2.74	2.94	5.16	17.23	24,368.0	+0.8	+ 9.6	+ 15.3
Chile	588	624	1,107	2.28	8,910.0	+1.8	+ 21.4	+ 22.3
Colombia	2,503	2,839	4,708	7.68	4,201.0	+3.7	+ 80.0	+ 99.9
Mexico	11.3	11.4	21.2	8.36	11,907.3	–0.9	+ 35.4	+ 34.8
Peru	3.31	3.48	6.23	2.94	3,598.9	–0.2	+ 47.8	+ 54.6
Venezuela	2,503§	1,598	4,707	13.03	29,832.0	+0.3	+ 34.4	+ 53.1
Egypt	6.25	6.15	11.75	10.40	23,006.7	+2.2	+ 97.7	+ 95.1
Israel	4.37	4.47	8.21	1.00	596.0	–0.1	+ 11.5	+ 12.2
South Africa	5.94	6.42	11.2	7.60	12,283.6	+0.3	+ 18.3	+ 32.9
Turkey	1,431,500	1,470,000	2,691,936	23.01	23,516.3	+4.2	+ 26.3	+ 23.9
Czech Republic	23.6	26.8	44.3	2.59	1,012.9	+5.4	+ 53.7	+ 67.4
Hungary	186	220	350	9.75	14,100.0	+1.6	+ 50.3	+ 67.7
Poland	3.20	3.92	6.01	6.80	24,852.8	–1.7	+ 19.4	+ 39.7
Russia	28.4	29.7	53.4	13.00	648.3‡	–3.7	+ 10.9	+ 14.3
EMF (MSCI)*	1.00	1.00	1.88	na	508.5	+0.1	+ 14.8	+ 14.8
EMBI+†	1.00	1.00	1.88	na	324.4	+0.2	+ 10.0	+ 10.0

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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